

Economic conditions in Germany

Macroeconomic situation

Quite strong economic growth in 2016 Q2

The German economy grew at a slower pace in the second quarter of 2016. According to the Federal Statistical Office's flash estimate, real GDP in the second quarter rose by a seasonally and calendar-adjusted 0.4% on the quarter, after recording a steep 0.7% increase in the first quarter. Aggregate capacity utilisation therefore remained at an above-average level. The weaker economic momentum was mainly attributable to a clear drop in investment in both machinery and equipment and in construction. Private consumption also grew less strongly than at the beginning of the year. By contrast, the outcome of the referendum on the United Kingdom's continued membership in the European Union (EU) did not appear to have had any effect on the German economy in the second quarter. The future impact of the referendum result will – at least in the short term – probably also be quite minimal.

Special factors in the case of investment

The weaker demand for new machinery and equipment probably represents a natural rebound from the surge in investment at the beginning of the year. Another possible factor is that industrial activity has not yet experienced a sustained recovery. For its part, the downturn in construction investment was largely due to weather-related factors, after exceptionally mild temperatures in the winter months had allowed additional building output in the first quarter. The slower pace of private consumption may also owe something to the turnaround from falling to rising oil prices, as this cancelled out the previously realised gains in purchasing power. On the other hand, the fairly robust export momentum had a stabilising effect on overall economic activity. The key factor here was the greater demand from within the euro area, which was sufficient to offset the sluggish momentum stemming from non-euro-area countries in the second quarter.

German exports proved to be a major mainstay of economic growth in the second quarter. This would indicate that the lull in demand observed in the second half of 2015 has now been overcome. Goods exports were markedly up on the quarter again in price and seasonally adjusted terms, with the regional figures available for April and May pinpointing exports to other euro-area countries as being the main driving force behind the positive result. Exports to other EU countries declined, however. Here, a sharp drop in the value of exported goods to the United Kingdom stood out in particular, although exchange rate effects probably played a part in this. Outside the EU, German exporters suffered substantial losses in their trade with Russia, but above all with the United States. The latter may have been in connection with the inventory adjustments in the United States, which generally have a strong impact

Exports remain a key growth factor

Overall output

2010 = 100, price- and seasonally adjusted



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



motor vehicle registrations following a strong increase in the previous quarter.

Construction investment also lost significant momentum in the second quarter. This, however, was due to a considerable extent to a correction to the weather-related surge in output in the first quarter. On the whole, the construction sector still appears to be in good shape.

Positive construction activity temporarily obscured by weather-related bounce-back effects

Seasonally adjusted private consumption was less buoyant in the second quarter than in the first three months of the year. The underlying economic conditions are still intact, however, owing to the ongoing positive outlook for income and the labour market. Additional support will also be generated this year by rising government transfer payments. The slump in the second quarter was probably due first and foremost to the turnaround in crude oil prices. Oil prices rose again perceptibly for a time following the sharp decline around the turn of 2015-16, eroding consumer purchasing power. Retail sales went up only marginally, and even posted a slight decrease in real terms. Footwear and clothing were the sole exception here, the demand for which saw a sharp rise following a lull in the winter months – probably due to the weather. By contrast, passenger car sales are likely to have continued exerting a positive influence on private consumption. This is shown by the increase in the second quarter in the number of new non-commercial motor vehicle registrations for the third period in succession.

Private consumption dampened by higher energy prices

on import demand. A noticeable increase was, however, recorded in exports to China. Exports to the OPEC countries also recorded strong growth following the period of stagnation at the beginning of the year, possibly in connection with the higher crude oil prices.

Investment activity tailed off in the second quarter of 2016. This was especially true in the case of machinery and equipment, where a countermovement took place following the brisk start to the year. Enterprises were, among other things, probably more reluctant to invest in their motor vehicle fleets, which would explain the very sharp drop in new commercial

Weaker investment in machinery and equipment

Imports fell substantially in the second quarter after adjustment for seasonal variations. This reflected the temporary slump in domestic demand. The real decline was stronger than in nominal terms, which was due to the fact that energy prices, and thus also import prices as a whole, rebounded following the slump around the turn of the year. In regional terms, the decrease in nominal goods imports was quite broadly based. There was much less demand for goods from countries outside the EU, in particular, especially the newly industrialised

Substantial decline in imports

economies in Asia, Russia, the OPEC countries, the United States and China.

■ Sectoral trends

Marked decline in industrial output, ...

Industrial output decreased distinctly in the second quarter and was down ¾% on the previous quarter after adjustment for seasonal variations. This narrowed the gap between industrial production, which had grown unexpectedly strongly at the beginning of the year, and the subdued development in orders in the winter half-year. Producers of intermediate and capital goods suffered a decline, with the sharpest drop in output (2¾%) being recorded by German manufacturers of machinery. Only manufacturers of consumer goods were able to step up their output slightly.

... but industrial activity still intact

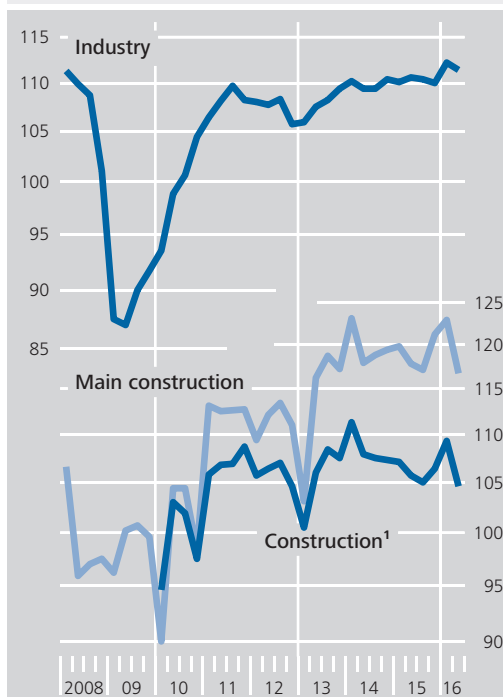
According to Ifo Institute data, the level of capacity utilisation of tangible fixed assets in manufacturing stood at 84¾% in July. It was therefore up slightly on the figure for April and perceptibly exceeded its multi-year average, which is regarded as the normal utilisation rate. This, combined with the progressive improvement in the business climate and the favourable business expectations, is an indication that industrial activity is still intact, despite the recent countermovement in output.

Construction activity contracting surprisingly sharply

Seasonally adjusted construction output declined surprisingly sharply compared with the first quarter of 2016 (-4¼%). Much of this decrease was due to the sharp increase in output at the beginning of the year, which was bolstered by the exceptionally mild weather conditions. Apparently, this did not result in additional output, which might have been expected given the good orders situation. On the contrary, it would appear that construction projects were merely brought forward and were therefore missing from the figures in the second quarter. This bounce-back effect was particularly pronounced in the main construction sector.

Output in industry and in construction

2010 = 100, seasonally adjusted, quarterly, log scale



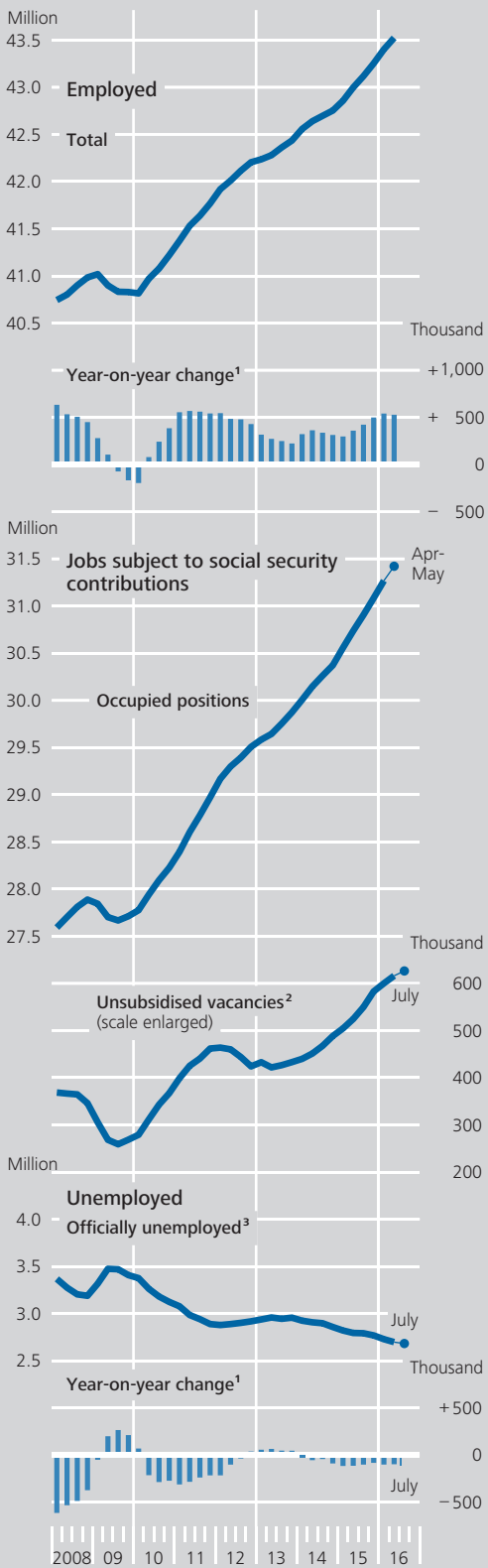
Source of unadjusted figures: Federal Statistical Office. 1 Main construction sector and finishing trades.
 Deutsche Bundesbank

The negative development in industry in the second quarter was reflected only to a limited extent in industry-related services. The economic indicators, for example, are showing just a sideways movement, but not a decline in wholesale revenue. According to the Ifo Institute survey, the assessment of the current situation in wholesale trade even showed an improvement in the second quarter. The assessment of the current situation in other services sectors also improved somewhat. Motor vehicle sales are likely to have decreased slightly, however, which is indicated by the sharp fall in the number of new motor vehicle registrations in the second quarter, following quite a considerable increase at the beginning of the year. The retail trade sector did not record any further revenue increases in the reporting period after having already reported weak growth in the previous quarter.

Services sector activity still robust

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.

Deutsche Bundesbank

Employment and labour market

The labour market situation remained very favourable. Both employment and the number of vacancies continued to rise. As in the preceding quarters, this was due mainly to the very buoyant growth of jobs subject to social security contributions. The underlying unemployment dynamics were likewise positive. However, the growing number of asylum application decisions led to an increase in the number of refugees registering as job seekers. The fact that total registered unemployment nonetheless continued to decrease can be explained by the greater use of labour market policy instruments.

Positive labour market developments continued in Q2

The seasonally adjusted number of persons in work in Germany rose by 121,000, or 0.3%, in the second quarter of 2016. The increase was therefore somewhat more moderate than in the first quarter of the year. It was again employment subject to social security contributions which increased in particular. According to the initial figures of the Federal Employment Agency, the number of employees subject to social security contributions in April and May alone rose by an estimated 0.4% (or 131,000 persons) on the average of the first quarter. By contrast, the trend in exclusively low-paid part-time employment, which has been declining since the introduction of the statutory general minimum wage at the beginning of 2015, came to a standstill of late. The number of self-employed persons is likely to have fallen slightly.

Virtually no change in favourable employment trend

Looking at the individual sectors, new positions subject to social security contributions were again created above all in the area of business-related services and in the health and social work sector. Both sectors combined accounted for roughly half of the increase in employment. A significant number of new positions were created in the public sector for the third quarter in succession. Job growth in the construction sector tailed off significantly, however, after it had expanded strongly in the winter

Increase above all in a number of services sectors

half-year. Manufacturing firms were also more reluctant to recruit new staff.

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

The high demand for labour is still being met to a considerable extent by immigrants. According to the migration statistics for 2015 recently published by the Federal Statistical Office, the (net) influx of foreign workers from other EU member states increased again slightly to 333,000 from an already elevated level. The number of persons migrating from east European EU countries alone amounted to 260,000. According to the immigration monitor figures of the Institute for Employment Research (IAB), in the last 12 months up to May 2016 slightly more than half of the growth in employment subject to social security contributions or in low-paid part-time work was accounted for by non-German nationals, primarily from other EU countries. By contrast, the inflow of refugees has barely been reflected in additional employment to date as many of the refugees can, initially, only be integrated into the German labour market to a limited extent. The number of persons in employment subject to social security contributions or working in low-paid part-time jobs coming from the most significant war-torn and crisis-stricken countries of Asia and Africa rose by just 32,000 compared with the same month one year earlier.¹

More under-employed refugees, but further drop in unemployment thanks to favourable economy and labour market policy measures

Registered unemployment fell slightly in the second quarter. Taking the average of the reporting period, 2.70 million persons were registered as unemployed in seasonally adjusted terms, which is 31,000 fewer than the average for the first three months of the year. The unemployment rate went down by 0.1 percentage point to 6.1%, which reflects the continued fairly robust underlying cyclical trend of the German economy. The use of labour market policy measures was stepped up significantly in connection with the growing number of refugees available to the labour market. This masks the rising number of underemployed refugees in the unemployment statistics. According to the Federal Employment Agency's definition, total underemployment (excluding short-

time work) – which also includes persons who are not counted as unemployed on account of their participation in labour market policy measures – went up by around 30,000 persons during the second quarter. This trend continued in July with a further decline in unemployment and an increase in underemployment.

The Federal Employment Agency published specific labour market statistics pertaining to refugees for the first time in June.² According to these statistics, 297,000 recognised refugees, asylum seekers and “tolerated persons” were registered as seeking employment in June, 131,000 of whom were unemployed. The remaining job seekers were not available to the labour market on account of their participation in integration or labour market policy measures or were employed for more than 15 hours per week and were therefore not counted as being unemployed. More than three-quarters of these unemployed persons were recognised refugees. Should these persons be in need of state assistance – which is the case most of the time – they receive the basic allowance for job seekers (unemployment benefit II) and are assisted by the job centres.

Labour market data on refugees available for the first time

The upbeat employment momentum should persist in the coming months. The most important leading employment indicators – the Ifo employment barometer, the IAB labour market barometer for employment and the Federal Employment Agency's BA-X job index – have remained very stable in the last few months. The results of the survey conducted by

Employment outlook remains positive

¹ See IAB (2016): Zuwanderungsmonitor Juli 2016, Aktuelle Berichte des IAB. The IAB counts 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 The current reporting practice in the Federal Employment Agency's statistics for persons with a nationality of one of the main countries of origin of asylum seekers (irrespective of their actual status and excluding refugees from other countries) has been enhanced to include the systematic recording of their “residence status”. See Federal Employment Agency, Geflüchtete Menschen in den Arbeitsmarktstatistiken – Erste Ergebnisse, Hintergrundinformationen, June 2016.



the German Chamber of Industry and Commerce (DIHK) in the early summer on enterprises' staffing plans, spanning a slightly broader horizon of 12 months, were positive, like those of the previous survey. The business services sector and, in particular, the public sector, reported more unsubsidised vacancies to the Federal Employment Agency. However, the number of reported vacancies also rose in the manufacturing and construction sectors. The subcomponent of the revised IAB labour market barometer that projects developments in unemployment in the coming three months has risen slightly of late. It is now marginally above the neutral threshold, pointing to a further slight decrease in registered unemployment over the next few months. A key factor in this is probably the expected increase in the use of active labour market policy measures in connection with the recent influx of refugees, which is why the growing numbers of refugees joining the labour market is having little impact on unemployment figures for the time being.

■ Wages and prices

The second quarter of 2016 saw overall earnings (including one-off payments and ancillary agreements) climb only modestly by +2.2% year on year, just as they had done in the first

Pay increases still modest in 2016 Q2

quarter. This was due not only to the moderate pay rises in the current pay round, which in some cases come into effect only after a several-month freeze at the old pay rates, but also to negative baseline effects owing to one-off and special payments in the second quarter of 2015, as well as to low graduated increases stemming from pay agreements negotiated in earlier pay rounds. Basic pay rates, too, showed only a modest further increase of +2.1% during the second quarter.

So far this year, new wage agreements have been concluded for just under 8 million salaried employees. The agreed volumes correspond to a moderate annualised wage increase of just under 2½%. In some industries, supplementary agreements were reached which have further increased wage costs and may therefore have curtailed the increase in pay rates. For example, contributions to certain supplementary pension schemes in the central and local government public sector will rise, while employers in the main construction sector will take on a larger share of food and accommodation expenses.

Mostly moderate agreements in current pay round

The Minimum Wage Commission unanimously recommended that the Federal Government raise the statutory general minimum wage to €8.84 from January 2017, which would represent a 4% wage increase for those who receive it. The recommendation was based on the general trend in negotiated wages between January 2015 and the end of June 2016, measured using the negotiated wage index of the Federal Statistical Office, excluding special payments and on an hourly basis.³ The Federal Minister for Labour and Social Affairs announced that this recommendation would be implemented.

Minimum wage to be raised to €8.84 per hour from 2017

Prices ceased their downward trend in the second quarter of 2016; instead, higher crude oil listings resulted in steep price increases

Energy-induced price rise at almost all levels

³ The Commission also factored in the increase in negotiated pay rates for public-sector employees of central and local government, which had in some cases not yet been implemented as at the reporting date, because it had become legally effective prior to June 2016.

across virtually all stages of the economy compared to the first quarter. Excluding energy, however, the underlying tendency remained muted, with the decline at the upstream stages tailing off noticeably. While the rate of price increases at the consumer level intensified somewhat, even after stripping out energy, this was mainly attributable to exceptional factors.

Excluding energy, falling price trend at import and producer level tailing off

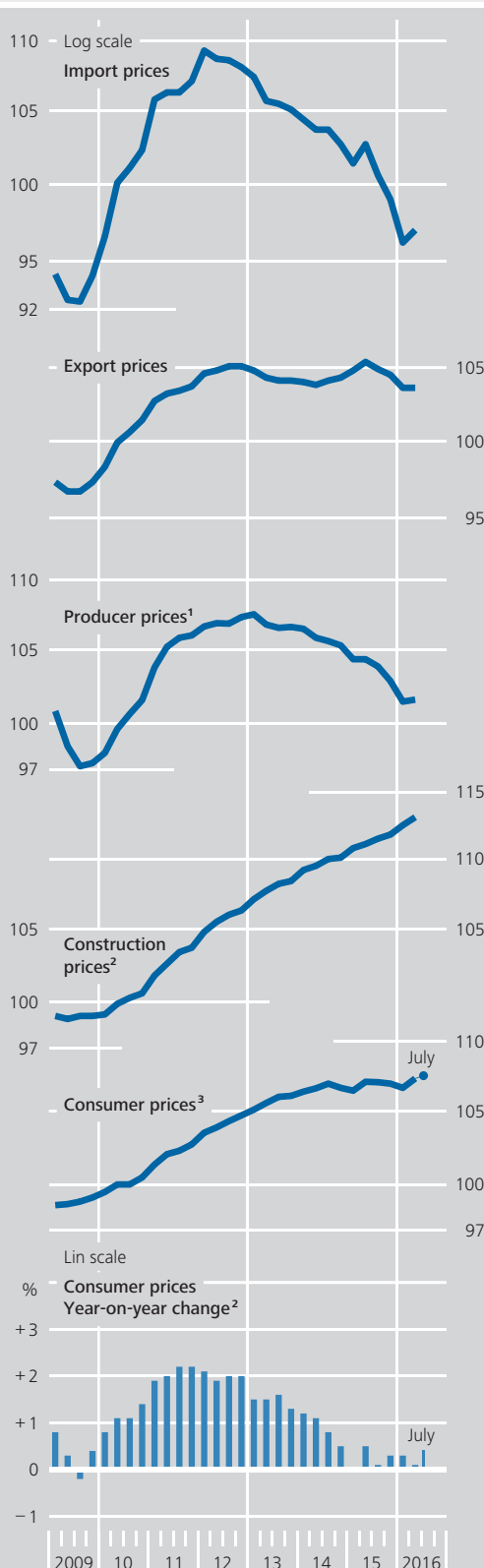
Import prices rose significantly in seasonally adjusted terms during the second quarter, mainly because energy prices surged following the pick-up in crude oil prices. Excluding energy, the considerable falling trend in prices seen in the preceding quarters tailed off. This was mainly because the pronounced negative price trend for intermediate goods petered out on the back of rising metal and ore prices. By contrast, the cost of imported consumer and capital goods continued to fall, probably also as a result of the euro's slight appreciation. Industrial producer prices flatlined after declining over the last few quarters. The rise in crude oil prices had less of an impact than at the import level, given the small weighting of petroleum products. It was also offset by the fact that the price of other goods continued to fall, albeit only slightly vis-à-vis the previous quarters. In comparison to the second quarter of 2015, however, prices at the industrial producer level dropped by 2.6% overall – only slightly less than in the first quarter. At the import level, the year-on-year price decline increased slightly to 5½%. Export prices fell less strongly than import prices year on year, leading to a marked improvement in the terms of trade.

Slight rise in construction prices, sharp rise in house prices

While the year-on-year increase in construction prices in the second quarter was still moderate, at +2.1%, it was slightly sharper than in the preceding quarters. Inflationary pressures in the real estate market intensified distinctly during the first half of 2016. According to the Association of German Pfandbrief Banks (vdp), the year-on-year rise in prices for owner-occupied housing averaged 5½% in the first two quarters of 2016 as against 4½% in 2015.

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

Jump in consumer inflation due to energy and special factors

Consumer prices rose by a seasonally adjusted 0.6% in the second quarter compared with the first three months of the year. Half of this increase was attributable to higher energy prices in the wake of the rise in crude oil quotations. While prices went up somewhat even after stripping out energy, this was mainly attributable to exceptional factors. Thus the surge in the price of commercial goods excluding energy can largely be explained by fluctuations in the prices of clothing and footwear, which have become significantly more volatile in recent years. Moreover, an adjustment to the minimum tax rate resulted in higher tobacco prices. Prices of food and services, including rents, rose only moderately by contrast. As the rate of inflation had likewise increased very sharply in the second quarter of 2015, the year-on-year increase as measured by the national consumer price index (CPI) dipped from +0.3% to +0.1%, and from +0.1% to 0.0% as defined by the Harmonised Index of Consumer Prices (HICP). Excluding energy, the rates held steady at around +1%.

Prices static in July

In July, seasonally adjusted consumer prices remained at the same level as in June. Although the price of petroleum products fell significantly as a result of falling crude oil prices, unprocessed food became much dearer, probably owing to the unfavourable weather conditions. Prices for industrial goods and services showed little change. Rents continued to increase only moderately. Both the CPI and the HICP climbed 0.4% on the year, after +0.3% and +0.2% respectively (excluding energy, each index rose by +1.3% after standing at +1.1%). Judging by recent forward prices for crude oil, headline inflation is likely to remain at a similar level over the next few months but may move above 1% in early 2017.

■ Orders received and outlook

The German economy should continue to grow in the third quarter in line with the fairly robust underlying cyclical upthrust. Despite the low

level of new orders received in the second quarter, the mood in German industry has improved distinctly. Notwithstanding the intense public discussion about the economic implications of the United Kingdom's announced departure from the EU, German firms have so far only slightly moderated their positive expectations. This supports the assessment that the economic consequences of the Brexit vote for Germany are likely to be very limited in scope, at least in the short term. German firms' positive expectations regarding foreign sales suggest that exports, too, will grow solidly in the third quarter. Overall, production by industrial firms should once again make a marked contribution to aggregate growth between July and September. Given that capacity utilisation is already above its average level, this should lead to more investment in machinery and equipment. Construction investment should also provide a greater impetus in the third quarter after the effects of the weather-related second-quarter bump in building activity have petered out, as is indicated by the positive sentiment and orders situation in the construction sector. In addition, private consumption should once more be a significant driver of domestic economic growth after faltering in the second quarter. Both employees' income prospects and the labour market situation remain favourable, and the preceding rise in crude oil prices has reversed.

At present, it is difficult to gauge the real economic impact that the UK's decision to leave the EU will have on Germany. The future framework for economic cooperation is still unclear and the associated negotiations will probably last several years. There might be short-term consequences if, for example, uncertainty causes German enterprises and consumers to postpone investment and spending decisions. However, the latest survey results indicate that this has barely been the case so far. Ifo Institute data suggest that although business expectations in manufacturing weakened in the wake of the referendum in the UK, they remain in positive territory and are still up on the first

Brexit has unsettled German firms and consumers only slightly, ...

Quite robust growth in Q3

quarter of 2016. Output and export expectations in industry have likewise deteriorated only slightly. The ifo Institute's surveys even showed a slight recent improvement in business expectations in wholesale and other services excluding trade. Moreover, according to a special survey conducted by the Chambers of Industry and Commerce,⁴ most firms in Germany are not planning to scale back their investment or headcount while negotiations between the UK and the EU take place. Consumers also remain confident. The consumer climate indicator, as estimated by the market research institution Gesellschaft für Konsumforschung (GfK), showed almost no change for August compared to July. The majority of the employees surveyed by the GfK do not fear that the result of the Brexit referendum will put their own jobs at risk.

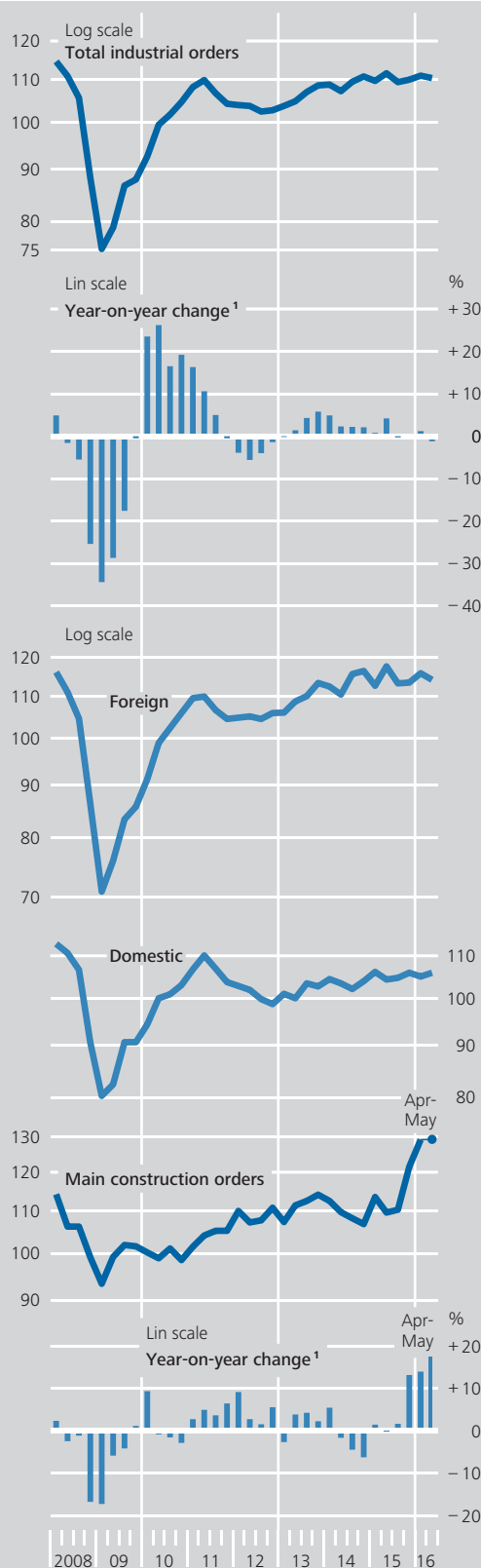
... but may impair foreign trade in short term

However, there may be certain consequences for foreign trade already in the short term, since it is being influenced by exchange rate changes and the increased levels of uncertainty in the UK. This uncertainty is depressing demand in the United Kingdom, which in turn is dampening imports – and thus Germany's exports. Germany exported €89.3 billion worth of goods to the UK in 2015. The gross value added of these exports is equivalent to around 2% of Germany's aggregate output, with the automotive sector accounting for the lion's share. The negative impact of the sharp depreciation of the British pound on German exports is being offset by the positive effects of the euro's depreciation against many other currencies. The German economy may also be affected, for example, if the UK's plan to leave the EU influences foreign direct investment and labour mobility.

⁴ The Chambers of Industry and Commerce carried out a survey on the real economic impact of the Brexit vote among 5,672 German enterprises between 27 and 29 June 2016. See also the press release issued by the German Chamber of Industry and Commerce (DIHK) on 7 July 2016; available at <http://www.dihk.de/presse/meldungen/2016-07-07-blitzumfrage-brexit>

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

Industrial orders down despite bigger demand from euro area

Industrial orders fell by ½% in seasonally adjusted terms in the second quarter. While non-euro-area countries were the biggest customers at the start of the year, orders from the euro area rose perceptibly during the second quarter, primarily benefiting German capital goods manufacturers. Significantly more domestic orders were received, too, particularly for intermediate goods and consumer goods. Orders from non-euro-area countries declined sharply, however. The turnaround in the regional pattern of orders was due mainly to big-ticket orders, with fewer coming from non-euro-area countries and more originating from Germany and the euro area. This indicates that the current export trend is likely to persist and that German industry will increasingly benefit from higher demand from the euro area.

Construction capacity utilisation remains high

Following a steep decline in the second quarter, the construction sector is likely to return to a growth path in the third quarter. The upbeat expectations in main construction business

edged up even more, while the volume of orders received remained at roughly the same level as in the second quarter. Combined with a marked widening in the temporal range of orders, this should result in a clear boost to demand, so that only supply bottlenecks could conceivably prevent a sharp increase in output. The breakdown of new orders among the individual construction subsectors was very mixed. The strongest stimuli came from orders for industrial and commercial buildings, whereas there were noticeably fewer orders for road construction.

The ongoing positive labour market situation, high income expectations, stable prices and the sizeable mid-year pension increases mean that favourable underlying conditions remain in place for dynamic consumption demand. The very optimistic consumer mood suggests that private consumption will continue to expand during the third quarter.

Good outlook for private consumption