

Economic conditions in Germany

Macroeconomic situation

Germany's strong economic upturn continues in Q3

The sharp upturn in the German economy is continuing. According to the Federal Statistical Office's flash estimate, real gross domestic product (GDP) in the third quarter of 2017 grew by a seasonally and calendar-adjusted 0.8% on the quarter on the back of very strong growth in the first half of the year.¹ This means that aggregate output has been expanding considerably faster than potential output since the beginning of the year. As a result, aggregate capacity utilisation is now probably being much more strongly utilised than on the longer-term average. Sentiment in trade and industry, which is at a record high, the excellent order situation in industry along with ongoing very positive consumer confidence suggest that the strong upturn in the German economy will also continue in the fourth quarter.

Industry is the main driver of growth

Buoyant industrial activity since the beginning of the year was the main driver of the strong upswing in the third quarter of 2017. Business-related services sectors, too, are likely to have shown marked growth in line with the brisk activity in industry. In the construction sector, on the other hand, which was still a second major driver of growth in the first half of the year, a further increase in activity was probably not possible. Given the high level of production, however, outstanding sentiment and large stocks of orders in the sector, this should not be interpreted as the end of the current construction boom.

External impulses on the demand side more in the foreground

On the demand side, GDP growth was broadly based. It was supported by both external and domestic stimuli, with the former coming more to the fore in the wake of buoyant global activity. Favourable sales opportunities in the export markets combined with rising capacity utilisation

contributed to a significant boost to investment in machinery and equipment along with exports. Following earlier large increases, private consumption is likely to have persisted at roughly the same level as in the previous quarter.

German exports rose significantly again in the third quarter of 2017. As in the previous quarter, German enterprises' export business – according to the figures available up to August – were the beneficiary, in particular, of strong demand from the euro area. This is a reflection of the continuing economic upturn in the other euro area countries. By contrast, exports of goods to non-euro area countries increased only marginally. Even so, developments were quite mixed in this respect. For example, the marked depreciation of the pound sterling led to a substantial fall in exports of goods to the UK in the third quarter. Trade with Russia also

Strong export demand, especially in the euro area

Overall output

2010 = 100, price and seasonally adjusted



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

¹ Furthermore, the growth rate in the first quarter was revised upwards by 0.2 percentage point to +0.9%.



suffered as a result of the depreciation of its national currency. While German exporters sold significantly fewer goods to the new industrial countries in Asia, exports to the United States, the south and east Asian emerging market economies and the OPEC countries were largely stagnating. Business with China was booming, however, and posted quite considerable growth. Significantly more goods were also being exported to Japan and to the countries of central and eastern Europe.

Against the backdrop of outstanding export activity and the ongoing increase in capacity utilisation, enterprises appear to have finally aban-

doned their caution to invest in new machinery and equipment. Investment in machinery and equipment is likely to have undergone a significant expansion in the third quarter of 2017 as well. This is suggested by the value of capital goods manufacturers' domestic sales, which were on a clear upward trajectory. The strong increase in capital goods imports – the figures for which are available up to August – likewise points to a high propensity to invest. Enterprises were clearly holding back on expanding their motor vehicle fleets, however. This is indicated by the number of commercial vehicle registrations, which fell significantly during the reporting period. It is difficult to ascertain how much this has to do with the discussion about imposing bans on older diesel cars in a number of German cities. This debate has not had any noticeable impact on motor vehicle production overall.

Investment in machinery and equipment still on an upward trajectory

Construction investment in the third quarter of 2017 was unable to match its strong upward momentum in the first half of the year. Nevertheless, construction investment is likely to have declined only marginally and still be at a very high level. Turnover in the main construction sector – figures for which are available up to August – indicates that enterprises have significantly expanded their investment in non-residential construction. Housing construction activity and public construction investment, on the other hand, are likely to have experienced a perceptible decline.

Construction investment at a high level

Following the extremely strong growth in the second quarter, private consumption in the third quarter of 2017 probably persisted at roughly the same level as in the previous quarter. Real retail sales (excluding motor vehicles) rose at a markedly slower pace than they did in the second quarter. In mail order business, in particular, there was a perceptible slowdown in sales growth in terms of value. Sales of furniture and furnishings and household appliances even showed a significant decline. By contrast, more information and communications technology (ICT) equipment was being sold and

Private consumption subdued in Q3

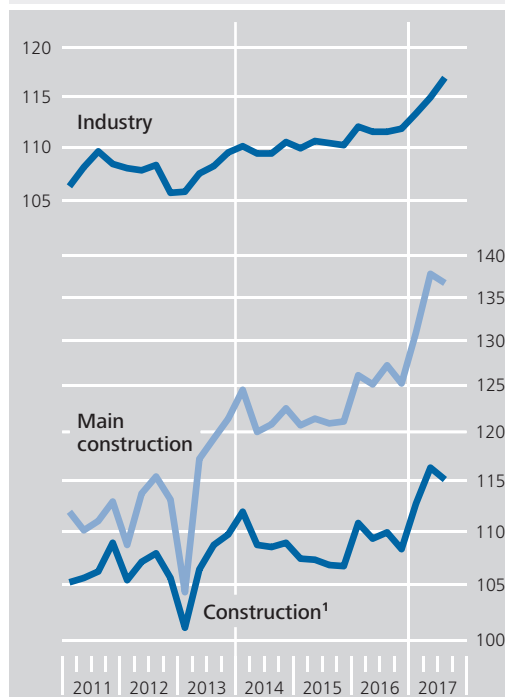
trade in textiles and clothing was also flourishing. Furthermore, car dealers probably recorded a significant increase in motor vehicle sales to households. This is suggested in any event by the quite considerably higher number of private passenger car registrations. The significant discounts and premiums for trade-ins of older diesel vehicles in connection with the recent emissions scandal might have played a part in such high sales figures.

Further rise in import demand

Imports grew significantly in the third quarter of 2017. This was due chiefly to brisk industrial and export activity, which was propelling demand for imported intermediate goods in particular. The high level of capacity utilisation in manufacturing is also likely to have led to a marked increase in capital goods imports. Owing to declining import prices, however, growth in the value of imports was substantially more muted overall. The regional breakdown – according to the figures available up to August – shows that considerably more products were imported, especially from other euro area countries. By contrast, import demand from non-euro area countries declined in terms of value. Consumer demand in Germany for goods from the United States was considerably weaker than in the previous quarter. Exports from China and Japan likewise fell substantially. Imports from the United Kingdom, on the other hand, showed a considerable increase, although the depreciation of the pound sterling is likely to have played a part in this. Also in very great demand were products from central and eastern Europe, the new industrial countries in Asia as well as the south and east Asian emerging market economies. The value of imports from the OPEC countries were also on an upward trajectory. This was probably due to the rebound in crude oil prices. Imports from Russia, on the other hand, showed a substantial fall in terms of value, probably as a result of the sluggish movement in natural gas prices.

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

■ Sectoral trends

Industrial activity remains very buoyant, and industrial output in the third quarter of 2017 even outpaced its already dynamic growth in the first half of the year. Output rose steeply by a seasonally adjusted 1¾% on the quarter. Although motor vehicle manufacturers recorded the strongest increase in output, overall growth was quite broadly based, which meant that output was stepped up considerably in other sectors, too. As a result, manufacturers of intermediate, capital and consumer goods expanded their production on a similar scale.

Industrial activity very buoyant

According to the Ifo Institute, utilisation of tangible fixed assets in manufacturing was also increasing on the back of the buoyant industrial activity, reaching its highest level in almost ten years. Capacity utilisation exceeded its prior-quarter level in the intermediate and capital

Even heavier utilisation of industrial tangible fixed assets

goods sectors, while it declined in the consumer goods sector.

Construction activity at a high level despite decline

Construction activity experienced a lull in the third quarter of 2017. After a very strong expansion in construction output in the first half of the year, activity in the construction sector declined significantly in the third quarter of 2017 in seasonally adjusted terms. Output in the finishing trades contracted somewhat more strongly than it did in the main construction sector where the no more than slight decline in civil engineering had a stabilising impact. Despite the lower overall level of activity, however, it should not be assumed that the current construction boom is coming to a sudden end. Rather, the construction sector is likely to be increasingly reaching the limits of its capacity, making it more difficult to expand output at the previous pace. This is suggested by the continuing high level of production, the substantial backlog of orders in the main construction sector, the high degree of equipment utilisation, the growing shortage of labour, and the assessment of the business situation in the main construction sector, which is at a record level.

Expansion in the services sector somewhat more subdued

Expansion in the services sector is likely to have been somewhat more subdued in the third quarter of 2017 than in the previous quarter. Price-adjusted wholesale sales probably declined slightly following a substantial rise in the second quarter. In line with this, the assessment of the business situation in this sector, which had reached a record level some time ago, declined somewhat, according to the Ifo Institute. Retail sales (excluding motor vehicles) and motor vehicle sales also grew rather sluggishly during the summer months. The number of newly registered passenger cars in the third quarter fell short of its high level in the previous quarter. However, robust growth in other services, excluding trade, is likely to have continued in the reporting period, as enterprises are still assessing the business situation in Germany very positively.

■ Labour market

The reporting quarter saw the dynamic expansion of the German economy bringing a further improvement to the existing very positive labour market situation. Employment rose strongly in the third quarter, unemployment continued to decline from its low level, and enterprises reported even more vacancies. The growth in employment was due primarily to an increasing number of jobs subject to social security contributions. By contrast, other forms of employment, such as exclusively low-paid part-time employment or self-employment, showed a slight decline. The outlook for the next few months remains favourable.

Labour market: situation and outlook still very favourable

In the third quarter of 2017, the total seasonally adjusted number of persons in work in Germany rose by 134,000, or 0.3%. This is roughly in line with the increase in the previous quarter. According to the initial figures of the Federal Employment Agency for July and August, the number of employees subject to social security contributions went up by as much as 0.5% compared with the second-quarter average.

Sharp rise in employment in Q3

The rise in regular jobs subject to social security contributions was broadly based. The largest increases in employment subject to social security contributions, in turn, were in business-related services (excluding temporary agency employment), the health and social services sector, as well as in the information and communication sector. On the other hand, the more moderate growth in temporary agency employment continued following the introduction, on 1 April 2017, of new regulations concerning the maximum period of labour leasing and the equal pay principle. In the manufacturing and construction sectors, growth in employment subject to social security contributions was similarly far below average, despite the positive orders situation. Supply shortages may be restricting larger-scale expansions in this instance. In both sectors, labour shortages are now being cited as the major obstacle to

Increase in employment subject to social security contributions broadly spread across sectors

an expansion in output.² In the finance and insurance industries, employment has contracted in recent months.

Increase in employment subject to social security contributions driven in equal part by German nationals and migrants

The increase of 746,000 in the number of employees subject to social security contributions in August compared with same month of 2016 was due in roughly equal part to German nationals and migrants. In the case of German nationals, these were, to a certain extent, persons switching from other forms of employment, such as self-employment or exclusively low-paid part-time employment. Given a trend decline in the number of German nationals of working age, the crucial factor is likely to have been the very high demand for labour motivating German nationals, as potential members of the labour force, to take up employment. Although no data are available at the current end about the development of age and gender-specific employment rates, the labour force participation of older persons is likely to have shown a considerable rise again after having been dampened for a time by the introduction of the option of retiring on a full pension at the age of 63. The labour force participation rate among women is also likely to have been going up, as in the previous years. The number of non-German nationals in jobs subject to social security contributions rose by 363,000 on the same month last year. The east European EU member states remained the most significant region of origin, even though their percentage share went down. Persons from the eight main countries of origin of asylum seekers also became a more significant factor in employment subject to social security contributions.³

Further decline in unemployment

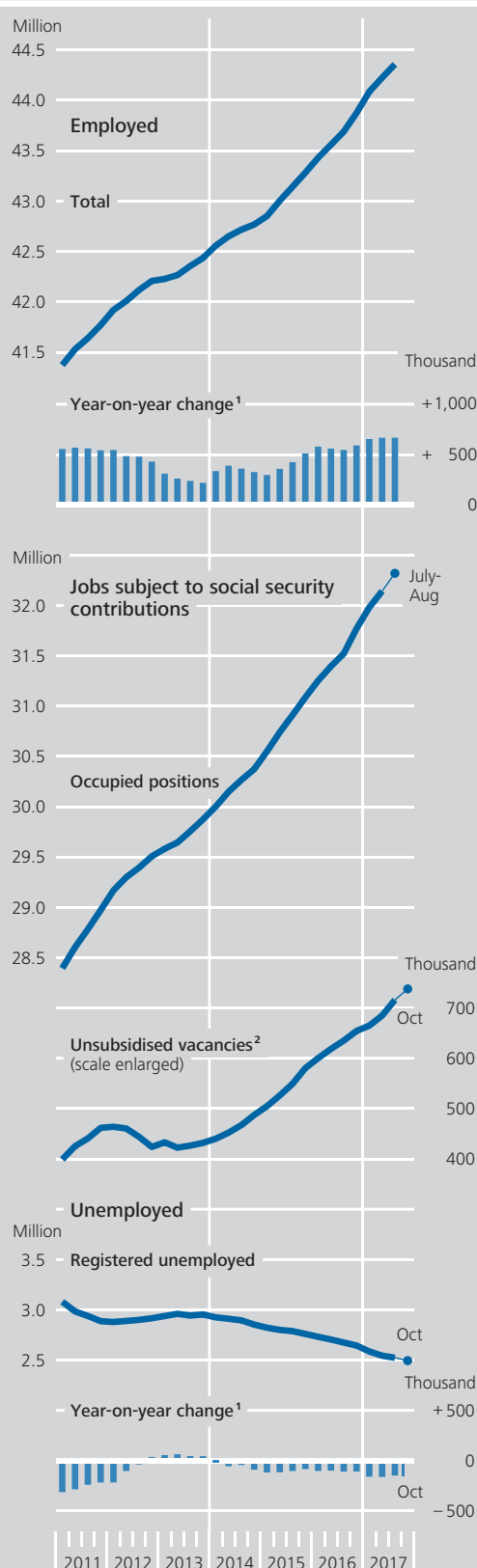
In the third quarter of 2017, registered unemployment declined somewhat more slowly in seasonally adjusted terms than in the pre-

² See DIHK-Economic-Survey Fall 2017.

³ See Federal Employment Agency, Statistik/Arbeitsmarktberichterstattung (2017): Migrations-Monitor Arbeitsmarkt – Eckwerte Deutschland (October), Nuremberg. The Middle Eastern countries of Syria, Iraq, Iran, Afghanistan and Pakistan, as well as the African countries of Eritrea, Nigeria and Somalia, are classed as being among the most significant countries of origin of asylum seekers.

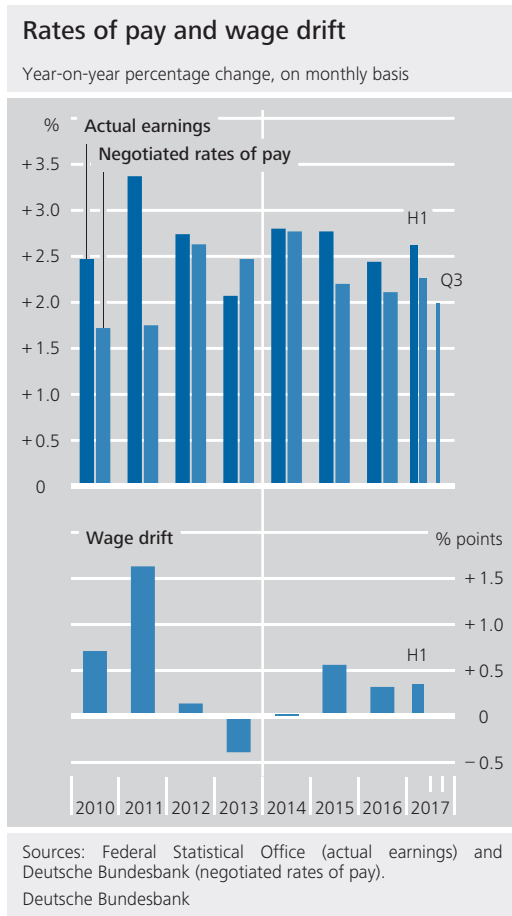
Labour market

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.

Deutsche Bundesbank



ceding quarters. On an average of the reporting period, the official unemployment figure was 21,000 lower than in the second quarter. The unemployment rate remained unchanged on average in the third quarter due to rounding, but has since declined and stood at 5.6% in October. The positive underlying cyclical trend is also reflected by the fact that significantly fewer German nationals as well as non-German nationals who are not refugees were registered as unemployed at the end of the period under review (-175,000 in October compared with the same month last year). This was, however, somewhat obscured by more persons being registered as unemployed in the context of forced migration. The slower rise in the number of such persons during the past few months is probably due to the increased use of labour market policy tools of the Federal Employment Agency and integration measures of the German Federal Office for Migration and Refugees.

The leading labour market indicators predict that the very favourable development will continue in terms of both employment and unemployment. According to the Ifo employment barometer, the employment plans of trade and industry for the next three months are still at a very high level and the autumn survey by the Association of German Chambers of Commerce and Industry also paints a similar picture for the next 12 months. The IAB labour market barometer also indicates a further expansion in employment. The Federal Employment Agency's BA-X job index is hitting ever new highs. This is mainly due to the rising number of reported vacancies for jobs subject to social security contributions, while the turnover in jobs tends to be stagnating. There was a particularly steep rise in the number of seasonally adjusted vacancies in the case of business-related service providers and in the production sector. At least in some instances, labour shortages are likely to be restricting employment growth. The unemployment subcomponent of the IAB labour market barometer has also shown a significant improvement recently, suggesting a further decline in the unemployment figure for the coming months.

Labour market outlook remains very good

Wages and prices

Wage growth remained moderate in the third quarter of 2017, as in the preceding quarters. At only 2.0%, the rise in negotiated wage rates including additional benefits and one-off payments in the third quarter of 2017 was just as weak as in the second quarter. The latest collective pay agreements likewise provide for no more than moderate wage increases. Moreover, low rates of growth in the second-stage of incremental wage increases as well as, in individual industries, months with a pay freeze based on agreements from the previous year are still having an impact. Extremely positive economic activity, staffing shortages in the labour market and the effects of the increase in the minimum wage at the beginning of the year suggest that actual earnings have gone up

Wage growth still moderate

more sharply than negotiated rates of pay. Weak productivity growth in earlier years is likely to have contributed to the long-discernible dampened wage growth. However, over the past few years it has been chiefly the high level of net migration from other EU countries which, with a time lag, has been curbing the wage-boosting effect of the increasingly tight labour market situation in Germany, as it has expanded the supply of available labour. If such wage-dampening factors become less important, wages and salaries could show stronger growth in future.

Exceptions to the general statutory minimum wage only until end of year

The last remaining exceptions to the general statutory minimum wage will expire by the end of 2017. However, in line with the generally binding minimum wage in their sector or with the statutory provisions, low-skilled workers in the meat industry, agriculture and forestry, horticulture, large laundries⁴ and newspaper delivery firms were still being remunerated below the rate of €8.84 per hour during the reporting period. From 1 January 2018 onwards, all employees will then be entitled to the statutory minimum wage⁵. The impact on the rise in actual earnings is likely to be marginal due to the relatively small number of employees affected.

Consumer prices excluding energy and food up significantly in Q3

In the third quarter of 2017, consumer prices as measured by the Harmonised Index of Consumer Prices were going up more sharply again after showing a slower increase for a time in the second quarter on the back of lower energy prices. The increase in prices, which was a seasonally adjusted +0.5% on the quarter, was just as sharp as in the final quarter of 2016 and the first quarter of 2017. Energy prices showed a further decline owing to the appreciation of the euro, despite higher crude oil prices, but food prices went up markedly at the same time, with roughly one-third of the increase being due to considerable increases in the price of butter. Prices of industrial goods (excluding energy) likewise rose distinctly, meaning that the appreciation of the euro, which was reflected in lower import prices, had probably

Import, export, producer 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** Harmonised Index of Consumer Prices. **3** Not seasonally adjusted. Deutsche Bundesbank

not worked its way through to the consumer level. Services became substantially more expensive overall. This was mainly on account of travel services, but the prices of other services (excluding rents) also showed a marked increase, as in the previous quarter. The increase in rents, which had been somewhat higher

⁴ The sectoral generally binding minimum wage of €8.75 per hour at the large laundries expired on 30 September 2017. In the agriculture, forestry and horticulture sectors, the sectoral generally binding minimum wage was raised as of 1 November 2017 from €8.60 to €9.10.

⁵ Exceptions to the general statutory minimum wage will continue to apply for certain types of traineeships, volunteers, persons under the age of 18 without vocational training as well as for the first six months of employment in the case of re-employment of the long-term unemployed.

than on the long-term average since the beginning of the final quarter of 2016, slowed down again. Overall, annual price inflation went up from +1.6% in the previous quarter to +1.7%.⁶ Excluding energy and food, the rate likewise went up by 0.1 percentage point to 1.5%, and was thus, as in the second quarter, well above its average since 1999. Admittedly, a part in this was played by the steep rise in the price of travel services, clothing and footwear, which generally fluctuate quite sharply (see pages 49 to 51). Even if these volatile components are excluded, however, the rate went up slightly to +1.3% and was thus above its average since the introduction of the euro.

Prices declining slightly in October mainly due to volatile components

In October, prices were down slightly on the month in seasonally adjusted terms, although food became significantly more expensive and housing rents were raised slightly. In particular, there was a distinct decline in the prices of services due to lower premiums for motor vehicle insurance and a perceptible fall in the price of package holidays, which was unprecedented to this extent in the same month of earlier years. Prices of industrial goods (excluding energy) were slightly lower on the whole due to clothing. There were no significant adjustments in the case of energy. The year-on-year figure decreased from +1.8% to +1.5% overall, partly because the prices of several components went up fairly sharply in October 2016.⁷ Excluding energy and food prices, the year-on-year figure showed an even more marked fall from +1.5% to +1.1%. However, if travel services and clothing and footwear are additionally excluded, the fall in the rate was noticeably smaller and remained slightly above the long-term average, even though the reform of long-term care at the beginning of the year was still having a dampening impact on prices.

Core inflation to accelerate in coming months; headline inflation volatile

It may be assumed that headline inflation will fluctuate sharply in the coming months, owing, above all, to base effects in the case of energy, food, travel and clothing. On the other hand, leaving aside these volatile components, the rate is likely to accelerate gradually. In industrial

domestic sales, there was a further hike in the prices of industrial goods (excluding energy) despite the appreciation in the second quarter. Furthermore, especially in the case of services, growing wage pressure is likely to go on being passed through to prices.

■ Orders received and outlook

Buoyed by flourishing industrial activity, the German economy is likely to remain on a strong expansionary path in the final quarter of 2017, too. The recent very strong inflow of manufacturing orders, in particular, suggests that industrial output will continue to make a significant contribution to aggregate economic activity. In line with this, the stocks of industrial orders still being processed have, according to the Ifo Institute, reached their highest level for more than a decade. Furthermore, brisk domestic and external demand, as well as the ongoing increase in capacity utilisation, are likely to make industrial enterprises significantly more willing to invest in new machinery and equipment. Nevertheless, a growing shortage of skilled labour might place greater constraints on further increases in output in future. This is indicated by the Ifo survey results on production hold-ups in manufacturing. In the construction industry, too, a dwindling supply of skilled workers is likely to prevent output from expanding sharply. For the time being, construction activity is therefore no longer expected to supply such strong stimuli for overall economic growth as it did in the first half of the year. Ultimately, the excellent labour market setting and the continuing favourable outlook for incomes will ensure that private consumption gives a boost to domestic activity.

Sharp upturn likely to continue

Sentiment in the German economy continues to be ebullient. In manufacturing, according to Ifo Institute data, there was an improvement in the assessment of both the business situation

Ebullient mood in German economy

⁶ The CPI figure was unchanged at +1.7%.

⁷ The CPI figure was +1.6% compared with +1.8%.

The volatility of the traditional core inflation rate in Germany

In the short term, inflation rates are often affected by very volatile components. This is why inflation measures which attempt to eliminate the influence of these volatile components in order to identify the underlying inflation trend play an important role for a monetary policy geared towards medium-term price stability. These types of core rates exclude certain components of consumption when measuring prices. Both internationally and in the euro area, the focus is usually on core inflation rates calculated using the consumer price index excluding energy and food. The fluctuations in the prices of these categories of goods are, for the most part, exceptionally strong and irregular because of the influence of international crude oil prices or due to weather effects, for example.

However, there are also other goods whose prices are often very volatile. This is shown, for example, by the fact that traditional core inflation has also been subject to sharp fluctuations in Germany of late. From mid-2016 to June 2017, annual HICP (Harmonised Index of Consumer Prices) inflation excluding energy and food initially rose clearly by 0.5 percentage point to 1.5% and remained at this level for a few months. It fell again markedly to 1.1% in October. Against this background, determining the inflation trend requires a more detailed examination of the causes of volatility in core inflation and not just an analysis of the traditional core inflation rates.

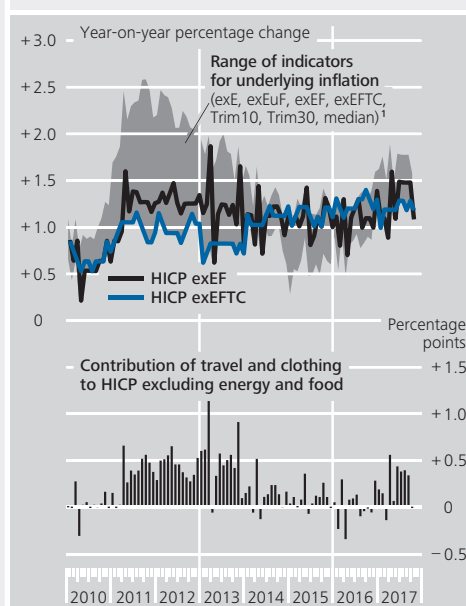
A detailed examination of the individual HICP components shows that the latest developments in the traditional core inflation rate were essentially determined by two variables, namely travel services¹ and clothing². Both components recently recorded a significant decline in inflation following a marked increase previously. Such strong fluctuations occur on a regular basis in inflation of these components, which likewise shows that the traditional core rates with their focus on energy and food do not exclude all volatile components of consumption – in many cases not even the most volatile.

Since travel services and clothing make up a relatively high share of the consumption expenditure of an average German household (just over 5% in each case), these price fluctuations

1 Travel services (HICP weighting in Germany 2017: 5.5%) are composed of package holidays (3.8%), passenger transport by air (0.4%) and accommodation services (1.3%).

2 Clothing (HICP weighting in Germany 2017: 5.2%) is composed of clothing materials (0.1%), clothing (3.8%), other garments and accessories (0.1%), cleaning, repair and hire of clothing (0.1%) and footwear (1.1%).

Underlying inflation in Germany

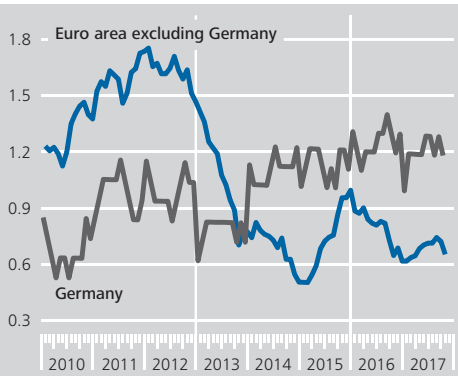


Sources: Eurostat, ECB and Bundesbank calculations. **1** exE = HICP excluding energy; exEuF = HICP excluding energy and unprocessed food; exEF = HICP excluding energy and food; exEFTC = HICP excluding energy, food, travel and clothing; Trim10 = the 10% trimmed mean; Trim30 = the 30% trimmed mean.

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HICP excluding energy, food, clothing and travel

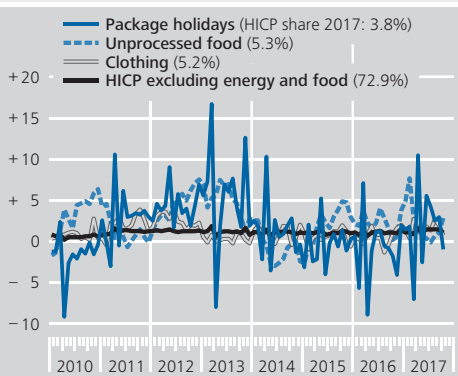
Year-on-year percentage change



Sources: Eurostat, ECB and Bundesbank calculations.
 Deutsche Bundesbank

HICP package holidays compared with other components

Year-on-year percentage change



Source: Eurostat.
 Deutsche Bundesbank

tuations have a clear impact on the core inflation rate. The high volatility of prices for travel services compared with the previous year can mainly be explained by package holidays, which represent most of the travel services in the HICP. When recording the prices for package holidays, different destinations are generally taken into account – in line with the travel habits of the German consumer. By way of exception to the standard price collection method,³ the composition of this component varies over the course of the year, as the consumer is, for example, more likely to travel to Greece in certain months, whilst at other times of the year Spanish destinations are more attractive. This means, for example, that year-

on-year rates for package holidays are more likely to be shaped by price developments in Spain in certain months, while Greek prices likewise have an effect during other months of the year. If inflation in Spain should essentially differ from that in Greece, the change in the composition of the basket of goods can be enough in itself to result in significant and irregular jumps in the annual inflation figure in certain months. A detailed breakdown of the movements in the HICP sub-index for package holidays into changes in the prices of individual destinations and changes in the composition of destinations in the basket of goods is not possible, as unfortunately no official data are available on price developments in the individual destination areas. For some time now, this has made it difficult not only to analyse prices but also to forecast inflation in the short term. It would therefore be helpful if the statistical database for recording package holiday prices could be expanded in such a way that more detailed information could be provided.

Overall, there may be monthly fluctuations of more than 10 percentage points⁴ in the annual inflation rate for package holidays. Not even the inflation rates for unprocessed food display such a high level of volatility. In the case of clothing and shoes, it is mainly the sales taking place at different times throughout the year which cause far greater fluctuations in the inflation rate than when there were still just two designated sales periods per year.

³ It is generally assumed that a basket of goods remains fixed over the course of the year when measuring prices. Alongside package holidays, exceptions here also include some food products and articles of clothing which are not available throughout the year. See G Elbel, *Behandlung saisonaler Erzeugnisse in der deutschen Verbraucherpreisstatistik*, *Wirtschaft und Statistik* 11/2010, pp 1022-1029.

⁴ Since the timing of the Easter and Whitsun holiday varies each year, the annual inflation rate, which is calculated using unadjusted figures, may fluctuate even more strongly in the months concerned. It is particularly difficult to isolate the effects of the moving public holidays on the package holiday price index as it is precisely in these months that the summer season begins.

Due to the high volatility of annual inflation rates for travel services and clothing, the traditional measure of core inflation in Germany also exhibits a fairly large range of monthly fluctuation considering it is a measure of the inflation trend; this can amount to more than 0.3 percentage point even when excluding the Easter and Whitsun effects.⁵ The same applies to other euro area countries, albeit to a lesser extent, as package holidays, for example, have a smaller weighting there and show less volatility.⁶

In order to be able to make a better assessment of the underlying inflation trend in Germany, it is therefore useful to factor out clothing and travel components from the traditional core inflation rate. Annual HICP inflation excluding energy, food, clothing and travel services rose relatively continuously from 0.7% to 1.3% in the period from the beginning of 2013 to the beginning of 2016, and since then has tended to move

sideways. By contrast, the corresponding inflation rate in the rest of the euro area has fluctuated around 0.8% since the beginning of 2014. In any case, it would seem appropriate to look at several indicators⁷ when determining inflation trends, rather than relying solely on any single measure of core inflation. For Germany, a selection of such indicators shows that underlying price pressures have gradually been increasing for some time now.

⁵ For example, HICP inflation excluding energy and food fell from 1.1% to 0.8% in February 2016. At the same time, the annual inflation rate for package holidays declined from 0.7% to -5.7%.

⁶ Weighting of package holidays in the HICP for the euro area excluding Germany in 2017: 0.9%. Standard deviation of annual HICP inflation rates for package holidays since 2010: 2.1 (Germany: 4.3).

⁷ For more information on this, see the comments on consumer prices in the euro area on p 17.

and business expectations. In addition, the positive short-term expectations about output and exports are evidence of the existing pronounced optimism among industrial enterprises. Sentiment in the main construction sector also continued to become brighter, climbing to a new record high. In the retail trade, too, there was a marked improvement in the assessment of the business situation and business expectations towards the end of the period under review. In the wholesale trade, however, sentiment became somewhat gloomier. The business climate in the services sector, excluding trade, remained optimistic. The most recent autumn survey by the German Chambers of Commerce and Industry (DIHK), which covers a longer time horizon of 12 months, also indicates that firms are looking to the future with confidence, with industrial enterprises, in particular, aiming to boost investment and employment.

German industrial enterprises were receiving considerably more orders in the third quarter than before, which suggests that industrial activity will remain buoyant up to the end of 2017. Excluding large-scale orders, which are often processed only over a relatively long period of time, the increase was, in fact, somewhat stronger and broadly based. The automotive sector, manufacturers of electrical equipment, machinery and basic metals and fabricated metal products benefited in particular from the strong surge in demand. In regional terms, the strongest impulses came from Germany and from non-euro area countries. By contrast, relatively few new orders were received from the rest of the euro area. The excellent order situation is also reflected in the latest survey indicators. According to the Ifo Institute, the stocks of orders that have still not been processed rose steeply to reach their highest level for almost 11 years. The reach of the orders, too, was still at an exceptionally high level.

Industry's order books well-filled

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

Following a slight decline in the third quarter, a moderate increase in construction output is likely in the final quarter of 2017. In July and August – statistical data are available up to then – the intake of orders in the main construction sector was significantly smaller than in the second quarter. This would be the second decline in succession, given that the volume of new orders in the second quarter was already clearly down on the very strong final quarter of 2016 and the first quarter of 2017. However, this does not mean that output will be cut back owing to a lack of demand, as Ifo Institute data indicate that the reach of new orders is still at a record high and there was a significant increase in the number of construction permits. Moreover, business expectations became distinctly brighter. In fact, supply-side constraints might increasingly limit further expansions in output. The percentage of enterprises stating that production is being impeded by labour shortages is at its highest level since the statistical records began and the utilisation of equipment in the construction sector has stabilised at a very high level. This suggests that capacity limits have largely been reached in the construction sector and that output therefore cannot continue to expand at the same pace as in the first half of the year.

Expansion in construction output increasingly limited by supply-side constraints

After a temporary lull in the third quarter, private consumption is expected to pick up again as the year draws to a close. The labour market is still in excellent shape and the consumer climate index compiled by the market research institution *Gesellschaft für Konsumforschung* (GfK) points to consumer sentiment being at a very high level. Moreover, according to Ifo Institute data, business expectations in the retail trade are clearly pointing upwards again following a rather weak performance in the third quarter.

Private consumption set to pick up again towards end of year