

Economic conditions in Germany

Macroeconomic situation

German economy booming

Germany's economy is booming. With aggregate economic activity already having surpassed potential output by a considerable margin in the first three quarters of 2017, economic output also saw a sharp increase in the final quarter, albeit with somewhat less momentum than before. According to the Federal Statistical Office's flash estimate, real gross domestic product (GDP) was 0.6% higher than in the third quarter in seasonally and calendar-adjusted terms. This was up 2.9% on the year after adjustment for calendar effects. Aggregate capacity utilisation is now significantly exceeding its long-term average. Business and household sentiment is exceptionally good, and the situation on the labour market has shown a further improvement. The excellent orders situation for industrial firms suggests that the rapid pace of expansion achieved in the course of 2017 is continuing into the new year. However, there are mounting signs that the German economy is increasingly being confronted with capacity constraints, which could stand in the way of significantly stronger growth.

Industry remains key driving force

In the final quarter of 2017, industry maintained its role as the major driving force behind the upswing. In its wake, business-related services sectors are also likely to have continued their dynamic upward movement. On the other hand, the construction sector, which has been facing considerable capacity shortages for some time, was unable to boost its output any further.

Demand-side growth driven mainly by exports and investment in machinery and equipment

On the demand side, economic growth in the final quarter of last year was driven chiefly by exports and investment in machinery and equipment. Flourishing global trade ensured strong sales growth among German exporters. Commercial investment in machinery and equipment, which had already been rising

briskly in the first three quarters of 2017, was expanded further in light of the high capacity utilisation levels. Private consumption, which had been a mainstay of the upswing up until the first half of 2017, fell into a lull in the summer and provided only limited additional stimulus towards the end of the year, too.

German exports rose sharply at the end of 2017. According to the statistical data which are available up to November, the products of domestic enterprises benefited from buoyant demand both within and outside the euro area, with exports to non-euro area countries growing much more sharply, however. Business with China remained on a clearly upward trajectory following quite substantial increases in the previous quarter. Exports of goods to the south and east Asian emerging market economies also expanded strongly. This was likewise the

Strong export growth at end of year

Overall output

2010 = 100, price and seasonally adjusted



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



case for exports of goods to the United States and the United Kingdom following their weak performance in the second and third quarters. In addition, there was considerable growth in sales of goods to central and east European countries. By contrast, the value of exports to the newly industrialised economies in Asia, as well as to Japan and the OPEC countries fell short of their third-quarter level.

In view of the further increase in capacity utilisation in the manufacturing sector and the favourable economic outlook, industrial firms' propensity to invest remained high. This benefited major branches of the German capital

Investment in machinery and equipment still on upward trajectory

goods industry. The mechanical engineering sector along with manufacturers of computers, electronic and optical products as well as electrical equipment were able to achieve a significant boost to their domestic sales. The high demand for investment also benefited foreign firms, as is indicated by the significant increase in imports of capital goods up to November. As was the case in the summer months, however, enterprises were still holding back on expanding their motor vehicle fleets in the final quarter of the year.

Construction investment remained lacklustre in the fourth quarter of 2017 and remained at more or less the extremely high level achieved earlier. Increasingly restricting capacity shortages may have been the main reason why there was no further growth in construction activity. The turnover figures for the main construction sector available up to November nevertheless indicate a considerable rise in private housing construction investment during the reporting period (see the box on pages 51 to 53 for details of housing price developments in 2017). By contrast, investment in commercial construction probably fell perceptibly.

Construction investment showing sideways movement

According to Federal Statistical Office data, households are likely to have largely kept their consumption expenditure at a high level towards the end of 2017, as they had done in the third quarter. Although households purchased considerably more passenger cars during the reporting period, this dynamic activity in the automotive sector is likely to have been due to discounts and premiums for trade-ins of diesel vehicles in connection with the emissions scandal. Real retail sales (excluding motor vehicles) continued to rise owing to the thriving business activity in online and mail order trade. By contrast, sales of ICT equipment saw a sharp decline at the end of the year. In addition, consumers cut back their expenditure on hotel and restaurant services and on foreign travel.

Private consumption subdued

Imports rose steeply in the final quarter of 2017 in quarter-on-quarter terms. According to the

More goods imports, especially from the euro area

figures available up to November, export demand for intermediate and consumer goods was particularly strong, and capital goods imports also rose significantly. In regional terms, significantly more goods were imported, particularly from euro area countries, whereas imports from non-euro area countries, after adjustment for price effects, were probably barely up on their third-quarter level.

■ Sectoral trends

Industrial boom continues

Industrial output remained on an upward path in the final quarter of 2017 and was up significantly (+1%) on its third-quarter level in seasonally adjusted terms. The strongest growth in output was in intermediate goods. Strong increases were posted, in particular, by manufacturers of chemical products. By contrast, the increase in production in the capital goods sector was much more subdued. This was due mainly to the automotive sector, which, following quite considerable growth during the summer months, fell slightly short of matching the high level of the previous quarter. Consumer goods production remained at the prior-quarter level.

Further rise in industrial capacity utilisation

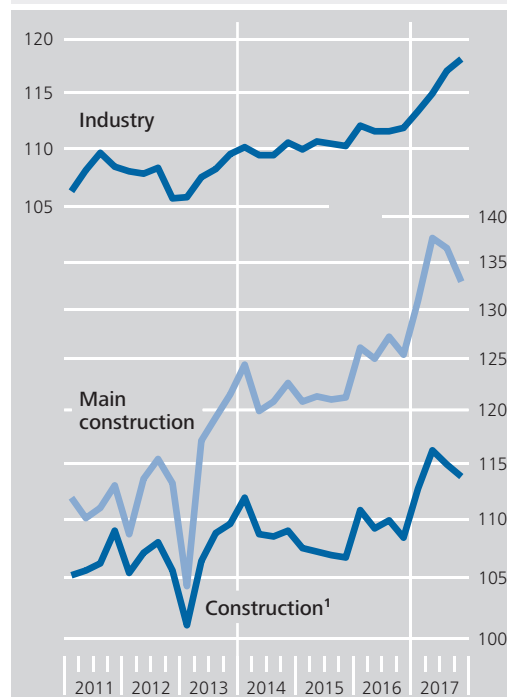
According to the Ifo Institute, utilisation of tangible fixed assets in manufacturing rose substantially on the back of the ongoing boom in industrial activity. It reached its highest level in a decade and was only marginally below its record high since German reunification.

Further decline in construction activity amid ongoing high capacity utilisation

Construction output declined significantly in seasonally adjusted terms in the final quarter of 2017 (-1%). The main reason for this was a sharp decline in construction activity in the main construction sector, especially in December. The fact that employees used up their remaining holiday entitlement at the end of the year may have played a part in this. The finishing trades, which expanded considerably in the reporting quarter, provided some impetus, however. As a result, overall construction activity was already contracting for the second time

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

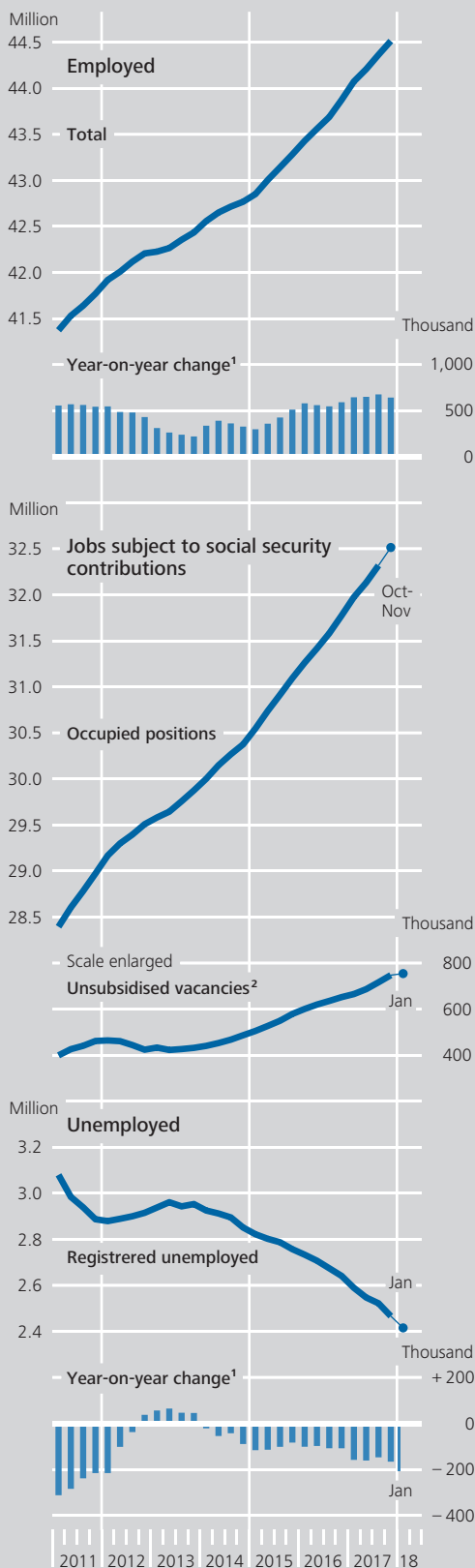
in succession following the exceptionally strong first half of 2017. There is a high and increasing percentage of construction firms, which, according to the Ifo Institute, have reported production hold-ups owing to the lack of skilled workers. This combined with the very high level of equipment utilisation and the fact that the reach of orders in this sector is far above average, indicates that the decline is due not so much to falling demand but rather to significant capacity shortages. This is consistent with the marked increase in construction prices.

Business activity in the services sector probably showed further marked growth in the final quarter of 2017. In the wake of brisk industrial activity, price-adjusted wholesale sales expanded substantially after posting fairly muted growth in the third quarter. The motor vehicle trade was also flourishing thanks to the high level of household demand for passenger cars. Price-adjusted retail sales (excluding motor vehicles) were also up. Overall, the broadly

Continued strong growth in the services sector

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

based and very upbeat sentiment indicates that the other services sectors also posted a significant increase in sales.

Labour market

Germany's labour market was again in excellent shape in the fourth quarter of 2017. As in the preceding quarters, employment rose sharply, especially in the case of jobs subject to social security contributions, among both German nationals and migrants. Unemployment declined further from its already low level. The number of job vacancies also continued to grow during the reporting quarter. Other leading indicators promise a similarly positive outlook for the next few months. Nonetheless, it may be becoming more difficult to fill vacant positions given the current high demand for labour.

Situation and outlook on labour market extremely favourable

In the final quarter of 2017, seasonally adjusted domestic employment increased by 150,000 persons, or 0.3%. As a result, total employment rose steadily at a strong pace for the third quarter in succession. This increase was due solely to the expansion in employment subject to social security contributions, which, according to initial estimates of the Federal Employment Agency (BA) for October and November, grew by 0.5% compared with the average of the third quarter. This contrasted with the declining trend in exclusively low-paid part-time employment and in self-employment.

Equally strong employment growth

The number of jobs subject to social security contributions increased across virtually all sectors. Particularly strong growth was recorded in business-related services, logistics and the information and communications sector. Following two weaker quarters, the number of employees subject to social security contributions in temporary agency employment was increasing more strongly again at the end of the period under review. The health and welfare sector as well as manufacturing and construction also made a significant contribution to

Almost all sectors creating new jobs

growth in regular jobs subject to social security contributions. Although the increase in the manufacturing sector intensified somewhat compared with the second and third quarters, growth was below average. In the finance and insurance sectors, employment also continued to decline towards the end of the period under review.

Shift in composition of migrants in employment growth

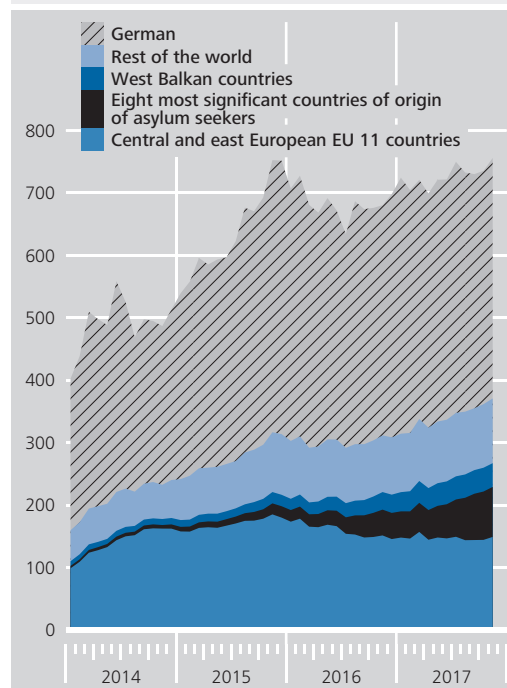
For a number of years now, there has been a persistently high demand for jobs subject to social security contributions. Despite inactive or unemployed persons being brought into the job market, satisfying this demand with members of the domestic labour force has been only partly successful. In November 2017, almost half of the 756,000 additional persons in employment subject to social security contributions (compared with 12 months earlier) were non-German nationals. Despite the diminishing relative importance in terms of employment creation, approximately every fifth additional person employed at the end of the period under review was a national of a central or east European EU member state. The integration of refugees into the labour market made further progress and – in addition to recruitment into work placements or mini-jobs – now also accounted for a significant share of just over one-tenth of the overall increase in employment subject to social security contributions.¹ In addition, the possibility of labour migration for persons from the West Balkan countries that was introduced at the end of 2015 – a response to the very high level of migration of asylum seekers from this region in the winter of 2014-15 – was also reflected in the fact that one in every 20 additional positions was filled by such a person.

Further decline in unemployment

Registered unemployment fell significantly in the fourth quarter of 2017 in seasonally adjusted terms. Taking the average of the reporting period, the decline, at 56,000 persons, was stronger than in the previous quarter. The unemployment rate was 0.2 percentage point down on the average of the third quarter. This positive development also continued in January

Employees subject to social security contributions broken down by nationality

Thousand persons, year-on-year increase



Quelle: Federal Employment Agency.
 Deutsche Bundesbank

with the unemployment rate standing at just 5.4% at the end of the period under review. The decrease was due mainly to the reduced numbers of long-term job seekers on welfare benefits. Although the chance of the long-term unemployed being able to take up employment again increased only slightly, there were relatively few unemployed persons – excluding refugees – transferring from the short-term insurance scheme to the longer-term welfare benefits scheme. The risk of becoming unemployed fell sharply, and most of the short-term unemployed are able to find a new job relatively quickly in the current situation.

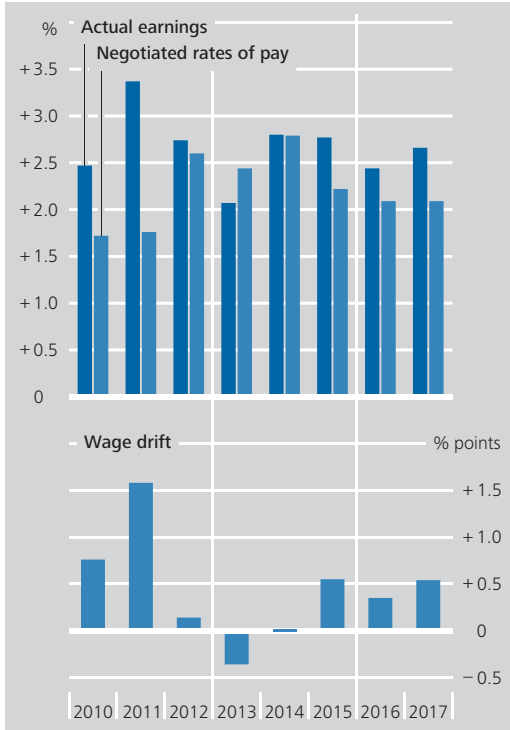
Enterprises wish to go on expanding their employment levels. According to the Ifo employment barometer, the intentions of enterprises in trade and industry for the next three months

Labour market outlook remains very positive

¹ Measured in terms of persons with a nationality of one of the eight main countries of origin of asylum seekers (Syria, Iraq, Iran, Afghanistan and Pakistan as well as the African countries of Eritrea, Nigeria and Somalia).

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

are extremely expansionary. This is also confirmed by the IAB labour market barometer and the Federal Employment Agency's BA-X job index. As in the past, more vacancies were reported, above all, in the case of business-related service providers and in the production sector. The fact that firms are experiencing difficulties in finding suitable staff is also likely to play a part here. The vacancy periods for open positions registered with the Federal Employment Agency were increasing significantly again towards the end of the period under review. The unemployment subcomponent of the IAB labour market barometer stabilised at a relatively high level recently and points to a continuation of the declining trend in unemployment for the coming months.

Wages and prices

In the fourth quarter of 2017, negotiated pay rates, measured by the high level of labour

market utilisation, continued to rise modestly. At 2.1%, the annual rate of growth in negotiated rates of basic pay was just as moderate as in the third quarter. Overall, negotiated rates of pay (ie including ancillary agreements) were up on their level one year earlier owing to base effects stemming from one-off payments in the previous year and annual bonus payments being lowered by just 1.8% in the reporting year. The already noticeably stronger increase in actual earnings in the preceding quarters is likely to have continued.

In 2017 as a whole, negotiated rates of pay (including ancillary agreements) – as in 2016 – also showed only a moderate rise on the year at 2.1%. To a certain extent, this was due to low pay increases from the second stage of earlier pay rounds that had been concluded under the impact of very low inflation in 2015 and 2016. Wage dynamics, however, were shaped to a greater extent by the moderate new agreements of the 2017 pay round. Besides weak productivity in some sectors, non-wage components, which are not reflected directly in the remuneration tables, are increasingly likely to have played a greater role in dampening the final pay agreements.

According to initial preliminary annual figures, the rise in actual earnings last year, at 2.6%, was significantly stronger than the increase in negotiated rates of pay, chiefly because of very positive economic activity and the shortages on the labour market. Added to this were wage-boosting stimuli from the raising of the general statutory minimum wage at the beginning of the year and the gradual phasing-out of sector-specific exemptions to the minimum wage.

This year's pay round covers major sectors such as the metal-working and electrical engineering industry, construction, central and local government and the chemicals industry and will affect around 9½ million employees. The trade unions' published wage demands so far amount mostly to 6% and are therefore of a slightly higher magnitude than in the previous

Negotiated pay rates continued to rise only moderately in Q4 2017

Only moderate wage increase overall in 2017, too ...

... but significantly positive wage drift

2018 pay round in favourable economic climate

Housing prices in Germany in 2017

Last year saw a continuation of the broadly based upward pressure on housing prices in Germany. Even so, there was no increase in the rate of inflation, which has been quite high for some time. While the prices of housing in urban areas were going up at a more or less undiminished pace, the rate of price increase in Germany as a whole declined somewhat. Unlike in previous years, interest rates did not decline further last year, which meant that they did not contribute to a further surge in demand. Furthermore, there is likely to have been a significant expansion in the housing supply in 2017. In urban areas, the prices of housing continue to be well above the level that would appear justified in terms of the longer-term economic and demographic determinants.¹

The price index of the Association of German Pfandbrief Banks (*Verband deutscher Pfandbriefbanken*, vdp) for owner-occupied housing in Germany went up by 5¾% last year, compared with an increase of 6% in 2016. Other housing price indicators, too, show that the rate of increase in residential property prices in Germany was somewhat slower in the reporting year. For the first three quarters of 2017, the latest period for which data are available, the house price index of the Federal Statistical Office shows house price growth of 4% compared with the same period of 2016. In 2016, the increase was 6%. Hypoport AG's Europace house price index (EPX) indicates that housing prices in Germany went up by 6¼% in 2017, which was 1¾ percentage points less than in the year before.

In German towns and cities overall, however, there was no easing of the upward pressure on the prices of housing. Accord-

ing to figures based on bulwiengesa AG data, residential property prices in urban areas in Germany continued to increase sharply by around 9%, and hence at a somewhat faster pace than in the three preceding years, when the increase averaged 7½%.² In Germany's seven biggest cities, where housing prices are already higher than average, housing inflation slowed down by 1¾ percentage points to 9¼%, but the rate was still above the average figure for the three preceding years.³ As in 2016, the rate of inflation for rental apartment buildings in the towns and cities as well as in Germany as a whole was markedly higher than for owner-occupied housing. The results for the towns and cities indicate that the demand for urban housing – not least in view of the extremely high price levels in the big cities – has continued to focus on locations outside the major cities that have been in high demand up to now. Given the somewhat more moderate price dynamics in Germany overall, urban centres appear to have gained in popularity compared with rural areas.

The continuing sharp price rises for housing in urban centres were accompanied by a significant increase of 7¼% in rents in new contracts, which are chiefly the outcome of rent adjustments in the case of repeat occupancies. In the big cities, rents for new lettings of existing dwellings were raised by

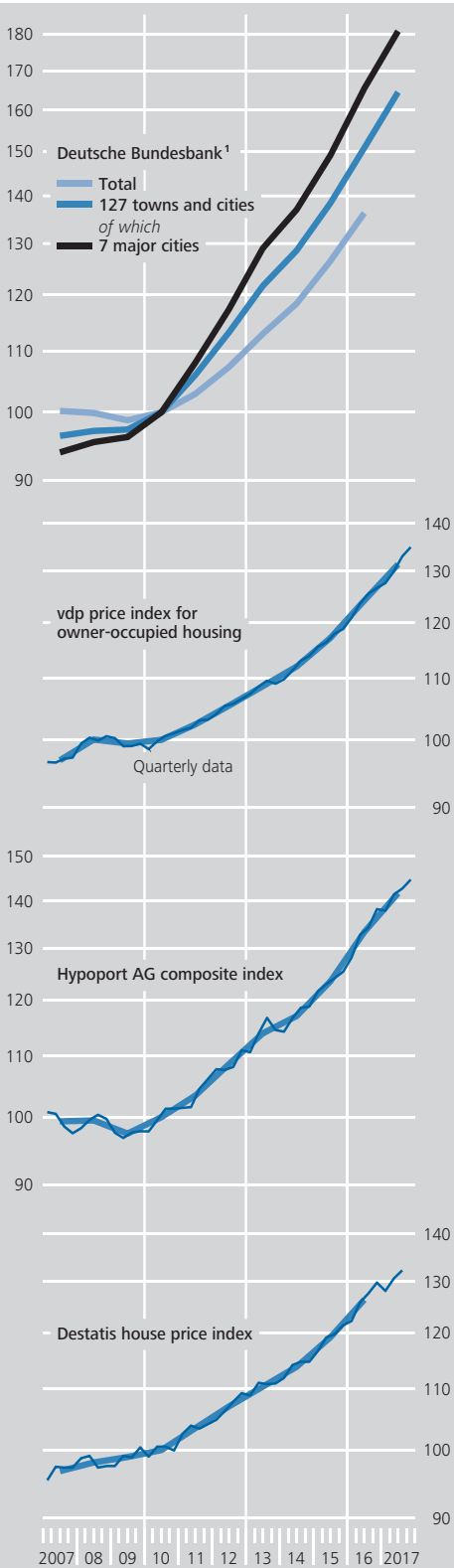
¹ These comments relate to how price developments in the housing market are to be seen in the context of the real economy. To assess them from a financial stability perspective, it is also necessary to take into account aspects connected with mortgage financing.

² Price data for housing in the 127 towns and cities in 2016 has been adjusted upwards by ¾ percentage point in the latest data release.

³ The seven biggest cities are Berlin, Cologne, Düsseldorf, Frankfurt am Main, Hamburg, Munich and Stuttgart.

Price indices for housing

2010 = 100, annual data, log scale



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

9¼%. Thus, rent inflation in the reporting year was at its highest since the start of the current boom in the housing market.

The positive outlook for households' incomes as well as the extremely favourable labour market conditions played a part in the strong demand for housing as it did in the year before. Interest rates for mortgage loans, however, were no longer generating any additional relief for households when purchasing residential property. The average mortgage rate, which had already hit an all-time low in the preceding year, settled at 1.7%, which was slightly above its 2016 level. In the reporting year, the aggregate housing price-to-income ratio went up from its heightened level by a little less than it did in the previous year.⁴ Moreover, in 2017, too, urban areas are unlikely to have become a less attractive residential option for domestic households or households which have newly arrived from abroad.⁵

It is estimated that, in 2017, the additional supply of housing was again markedly larger than in the previous year, in which some 278,000 units were completed. A large part of this is likely to consist of apartment block construction as well as a marked expansion in the available housing in the category of residential homes, which includes accommodation for refugees. The number of planned housing units, on the other hand, declined last year for the first time since the start of the housing market boom. At an estimated number of around 345,000 units, roughly 7.5% fewer permits

⁴ See the Deutsche Bundesbank's system of indicators for the German residential property market, available at http://www.bundesbank.de/Navigation/EN/Statistics/Enterprises_and_households/System_of_indicators/system_of_indicators.html

⁵ According to data from the regional database of the Federal Statistical Office, in the period from 2011 to 2015 the percentage of the population living in towns and cities went up by 4.1%; in the big cities, the increase was 5.5%.

were granted than in 2016, when special factors contributed an extremely sharp increase of more than 20%.⁶ Given the very high level of capacity utilisation as well as the accumulated stock of orders for the construction of buildings, the increase in prices for construction work on new residential buildings in 2017, at 3%, was again stronger than in the previous year, which had already seen a perceptible rise. Even so, the high cost of expanding available land still represented the main constraint on an expansion of housing. According to Federal Statistical Office data, the prices of building plots went up by around 12% in the first half of 2017. This followed a marked increase in 2016 compared with the annual average dynamics of the period from 2010 to 2015.

In sum, the heightened price dynamics of residential real estate may have continued in the past year to exceed the rate that would have been appropriate in terms of the demographic and economic fundamentals. According to current estimates, price exaggerations in urban areas overall in 2017 amounted to between 15% and 30%.⁷ In the big cities, where considerable overvaluations had already been measured earlier, the price deviations are likely to have increased further to 35%. Other standard indicators for assessing price developments in residential real estate likewise suggest that, especially in the towns and cities, prices have continued to go up relative to their fundamental determinants. For example, the price-rent ratio for apartments in urban areas, which had already shown a marked rise earlier in the wake of the housing market boom, was around 15% higher last year than its long-term average since German reunification. In the seven big cities, residential property overvaluation at the end of the period under review was 25%.⁸ The price-rent ratio in these areas last year was

therefore at its highest since the early 1990s.

6 Some of this may have been due to anticipatory effects regarding construction permits in connection with the more stringent energy standards for new residential buildings after the end of 2015/start of 2016.

7 These figures are based inter alia on a regionally differentiated estimation model. They refer to an estimated fundamental residential property price, which is conceptually based on the sustainable components of economic and sociodemographic factors. See F Kajuth, T Knetsch and N Pinkwart, 2016, Assessing house prices in Germany: evidence from a regional dataset, *Journal of European Real Estate Research* 9 (3), pp 286-307. As usual, price data for the year 2017 are currently available only for the subcategory of towns and cities. The estimates on which the current figures for overvaluations are based refer to the estimation period until 2016, up to which year the district-specific price information for Germany as a whole is available.

8 In this figure, the contribution of the exceptional decline in interest rates in the period from 2010 to 2016, which, taken in isolation, increased the actual price-rent ratio, also flows into the reference measure. In a hypothetical scenario without a decline in interest rates since 2010, the reference value would be significantly lower and the price deviations would be larger.

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

year. The underlying macroeconomic conditions with strong economic growth and growing shortages in the labour market suggest that wage increases will be perceptibly larger overall than in previous years. This impression is reinforced by the most recent pay agreement in the metalworking and electrical engineering industry, which features a permanent increase of 4.3% in scheduled rates of pay from April 2018 as well as further significant improvements to remuneration in 2019. Furthermore, one notable feature of the agreement in this key sector of Germany industry are the, in some cases, innovative models that have been created to

allow more flexible working hours arrangements.

At a seasonally adjusted figure of 0.4%, consumer prices as measured by the Harmonised Index of Consumer Prices (HICP) showed a clear quarter-on-quarter increase again at the end of 2017. This was due mainly to higher energy prices, which were caused by the sharp acceleration in crude oil prices, and to the cost of food. If these two components are excluded, inflation was noticeably weaker. Substantial reductions in the prices of travel services and car insurance policies had a dampening impact on services, which had become considerably more expensive earlier. Although there was also an easing of price pressure on non-energy industrial goods, it remained positive despite the downward trend in import prices for non-energy goods since the euro's appreciation in the second quarter. The overall year-on-year rate stayed more or less constant at 1.6%; excluding energy and food, however, it fell from 1.5% to 1.2%.²

Another marked rise in consumer prices in Q4; core inflation rate significantly dampened by special factors

HICP inflation surged from 0.4% to 1.7% on an annual average of 2017, mainly because of the rebound in energy prices, but also as a result of more rapidly rising food prices.³ Core inflation (excluding energy and food) went up to 1.3%, after remaining at 1.1% for three years. This increase was a reflection, above all, of a higher rate of inflation for non-energy industrial goods. Since the launch of European monetary union, it was only in 2012, when the euro depreciated strongly, and in 2007, when there was a significant hike in value added tax, that the rate was so high. In the case of services, the increase in the rate of inflation was ostensibly more moderate; what should also be taken into consideration, however, is that the reform of long-term care at the beginning of 2017 had a dampening impact on the figure. Overall, the accelerating core rate corresponds

Core inflation for 2017 as a whole in line with growing aggregate overutilisation

² Annual headline CPI inflation held steady +1.7%.

³ The CPI figure was +1.8% compared with +0.5%.

quite well with increasing aggregate overutilisation.

Volatile components dampen consumer price inflation in January

Seasonally adjusted consumer prices were unchanged on the month overall at the beginning of 2018, however. Annual headline HICP inflation went down from 1.6% to 1.4% and the index, excluding energy and food, fell slightly.⁴ This was mainly due to a marked decline in the prices of travel services and clothing, both of which are very volatile.⁵ With regard to clothing prices, another factor may have been that sales of winter goods probably suffered as a result of the comparatively mild weather. However, leaving aside these two components, core inflation rose to 1.4% once the negative contribution of the long-term care reform had disappeared. This was because prices of other services and industrial goods (excluding energy) continued to go up. By contrast, prices of energy and food changed only slightly.

■ Orders received and outlook

Robust economic growth continues

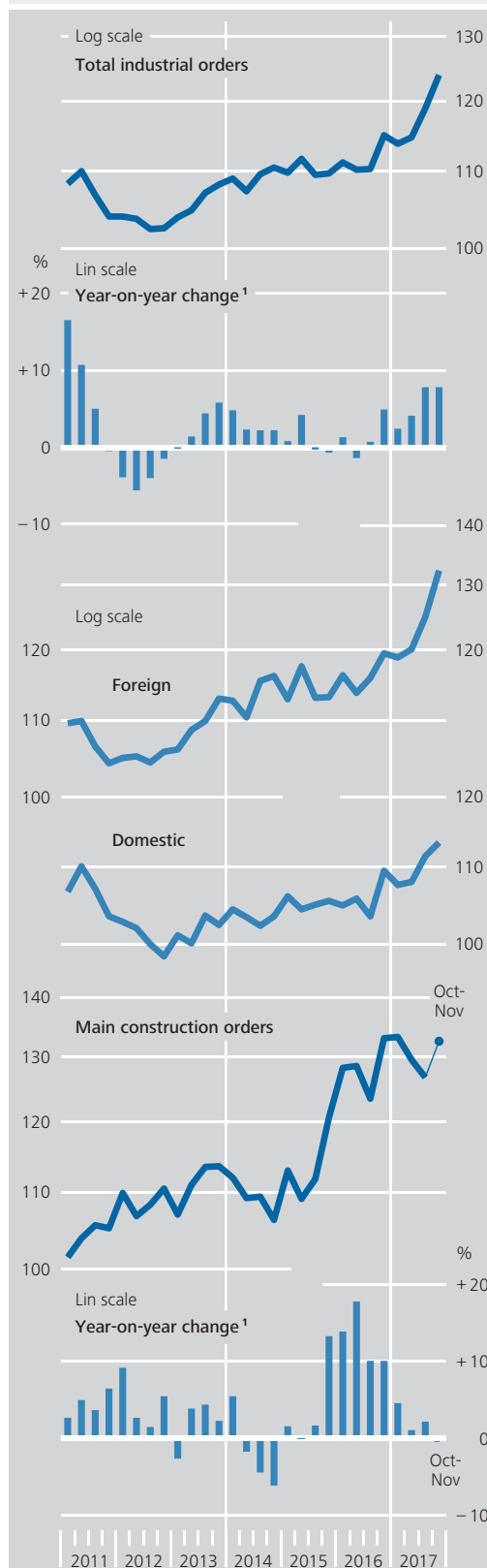
The first quarter of the new year is likely to have seen the German economy maintaining the high average pace of expansion achieved in 2017. Given the very large inflow of new orders during the period under review, the industrial sector will probably remain the key driver behind the upturn. The associated ongoing very high level of utilisation of tangible assets in manufacturing is likely to give a further boost to enterprises' willingness to invest in new machinery and equipment. Nevertheless, according to the Ifo Institute, the percentage of manufacturing firms reporting production hold-ups due to the lack of skilled workers is on the rise, and this might gradually place limits on an expansion of output.

⁴ Annual headline CPI inflation was +1.6% compared with +1.7%.

⁵ See Deutsche Bundesbank, The volatility of the traditional core inflation rate in Germany, Monthly Report, November 2017, pp 49-51.

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

Unchanged positive sentiment in German economy

Sentiment in the German economy is still characterised by a great deal of optimism. The Ifo Institute's business climate index for trade and industry continued to be at a very high level at the start of the new year. A slight deterioration in business expectations contrasted with a marked improvement in the assessment of the business situation. This was especially true of manufacturing. There was barely any change either in the extremely positive sentiment in other sectors – main construction and wholesale and retail trade. According to the Ifo Institute, confidence was also unbroken in the rest of the services sector (excluding wholesale and retail trade). This picture of exceptionally positive sentiment is consistent with the results of the survey conducted by the German Chambers of Commerce and Industry (DIHK) at the beginning of the year, which is based on responses from a large number of firms and where, in some cases, expectations refer to a longer time horizon of up to one year. Compared with the autumn survey, the assessment of the business situation as well as enterprises' business and export expectations showed a marked improvement. Firms' investment and employment plans were likewise clearly pointing upwards.

Outstanding orders situation in industry

There was a further very steep rise in industrial orders towards the end of 2017. This is striking given that they had already increased considerably during the summer months. It is true that the inflow of new orders in the fourth quarter was due primarily to large-scale orders which have an impact on output only after a time lag, but there was strong growth even if these orders are not taken into account. Broken down by sector, the surge in orders was broadly based. In regional terms, impulses from abroad were predominant. Demand from the euro area was particularly strong, although there was an exceptionally high share of major orders

for other transport equipment, which often originates from primary demand in non-euro area countries. The inflow of orders in the second half of the year was so strong that the reserves of orders showed a sharp increase despite a marked expansion in production. According to the Ifo Institute, the stocks of orders that have still not been processed hit a new all-time high. The range of orders also exceeded its previous peak.

October and November – statistics are available up to then – saw a sharp increase in new orders received by the main construction sector compared with the third quarter. More orders were received mainly in housing construction and, to a lesser extent, in civil engineering. However, notwithstanding the high level of demand and the well-filled order books – and apart from the one-off effects possibly triggered by the mild weather in January – construction output is likely to have shown no more than a moderate increase in the first quarter of 2018. According to Ifo Institute surveys, this sector is facing significant capacity shortages in terms of both the very high level of equipment utilisation and the considerable shortage of skilled labour.

Construction sector probably at full capacity

The underlying conditions for private consumption, which probably underwent a lull in the second half of 2017 following strong growth in the first half of the year, remain favourable. This includes the extremely positive outlook for employment and a substantial rise in earnings. In line with this, consumer sentiment is still at a very high level according to the consumer climate index compiled by the market research institution Gesellschaft für Konsumforschung (GfK). According to the survey findings, consumers' expectations about the economy, in particular, were clearly brighter towards the end of the period under review and reached their highest level in seven years.

Still favourable underlying conditions for private consumption