

Economic conditions in Germany

Macroeconomic situation

German economy continued on strong growth path in Q2

The German economy continued to experience rapid growth in the second quarter of 2017. According to provisional data from the Federal Statistical Office, real gross domestic product (GDP) in the second quarter grew by a seasonally and calendar adjusted 0.6% compared with 0.7% in the preceding three-month period.¹ GDP growth was therefore much faster than potential output in both quarters and overall capacity utilisation, which was already significantly above average, showed a further marked rise. Exceptionally upbeat sentiment among both enterprises and consumers along with the positive order situation in industry suggests that the German economy is also likely to continue to grow with strong momentum in the current quarter. The fairly brisk underlying pace of economic growth last year

owing to buoyant domestic activity accelerated further towards the end of the period under review owing to a more favourable external environment. Overall, GDP growth in the current year could even be somewhat stronger than expected in the June projection.²

As in the first quarter, the strong economic growth in the second quarter of 2017 was due mainly to the buoyant upturn in industry and construction. After some ups and downs last year, industrial output moved onto a clear growth path at the turn of the year. This also had a knock-on impact on business-related services sectors, such as the wholesale trade sector. The boom in the construction sector continued and there was a further considerable increase in output.

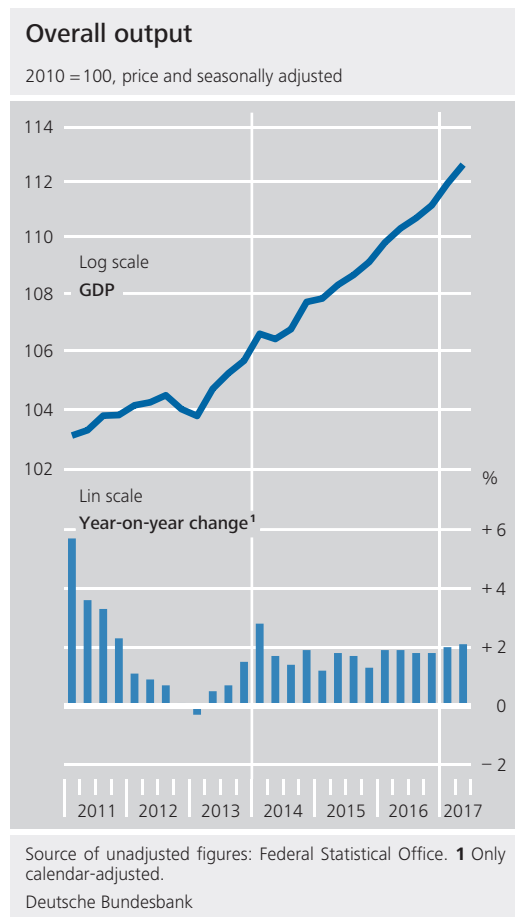
Industry and construction as key drivers

Looking at demand, the recovery continued to be broadly based. Exports were still on the rise, mainly thanks to stimuli from the other euro area countries. In addition, there was a further expansion in investment in machinery and equipment. The fact that this overcame its sustained period of sluggishness is probably due chiefly to increasing capacity utilisation in the industrial sector and the positive outlook for sales. Private consumption is also likely to have made a major contribution to growth in GDP.

Demand impulses broadly based

Following their strong showing in the fourth quarter of 2016 and the first quarter of 2017, German exports continued to grow at a somewhat slower pace in the second quarter. According to the figures available up to May, stimuli from the other euro area countries were

Further rise in exports



¹ GDP growth was revised upwards by 0.1 percentage point in the first quarter of 2017. Following the usual mid-year revision of previous years' data, GDP growth was revised upwards by 0.3 percentage point in 2014 and by just under 0.1 percentage point in 2016.

² See Deutsche Bundesbank, Outlook for the German economy – macroeconomic projections for 2017 and 2018 and an outlook for 2019, Monthly Report, June 2017, pp 11-27.

a key factor in this. The ongoing and robust economic recovery in these countries was reflected in a considerably higher demand for German products. By contrast, growth in sales to non-euro area countries was comparatively modest. In terms of value, significantly more goods were exported, especially to central and east European countries, the United Kingdom, the OPEC countries and Japan. There was a marked fall in exports to the United States and China, however. German exporters' trade with Russia was moving somewhat towards a normal level again following the quite significant rise in the previous quarter, but was still very strong compared with the final quarter of 2016. This reflects the fact that the Russian economy has overcome its severe recession of recent years.

Investment in machinery and equipment on expansionary course

Private investment in machinery and equipment appears to have recovered from last year's cyclical lull and has taken on a somewhat brisker pace since the turn of the year. Enterprises are also likely to have significantly stepped up their investment in machinery and equipment in the second quarter of 2017. The value of sales of capital goods producers in Germany and capital goods imports both showed a further increase in the second quarter. Furthermore, the higher number of motor vehicle registrations indicates that commercial owners have been building up their fleets significantly. The greater amount of investment in machinery and equipment by enterprises is likely to have been due, above all, to the marked strengthening in industrial activity at the end of the period under review and the high and increasing level of capacity utilisation in manufacturing.

Construction investment still very buoyant

Construction investment, too, is likely to have risen again sharply in the second quarter of 2017 on a broad front. The turnover figures for the main construction sector, which are available up to May, show that, along with the very dynamic activity in housing construction, commercial non-residential construction and public sector construction picked up perceptibly.

Foreign trade

Seasonally adjusted, quarterly



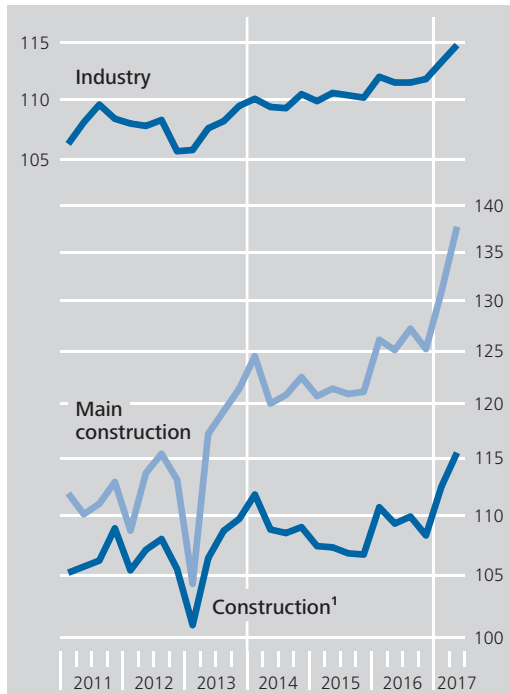
Source of unadjusted figures: Federal Statistical Office. 1 Adjusted using the price indices for foreign trade.
 Deutsche Bundesbank

Private consumption is likely to have increased noticeably in the second quarter. Consumers were in an exceptionally positive spending mood owing to very high income and economic expectations. Real retail sales (excluding motor vehicles) posted a sharp increase and thus rose considerably more strongly than in the previous quarters. All major categories of goods benefited from the buoyant consumer demand. Online shopping and mail order sales showed especially sharp growth. The significant increase in trade in information and communication technology (ICT) equipment also stood out given the already fairly substantial rise in the previous quarter. By contrast, there

Private consumption benefited from buoyant consumer spending

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.
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was a tailing-off in demand for motor vehicles. At all events, the number of private passenger car registrations decreased. It is not possible at present to say with any certainty how far this was due to uncertainty among buyers resulting from the diesel emission problems of a number of German car manufacturers, which was already increasingly being talked about in the second quarter. Measured by the total number of registrations, foreign group brands gained further market shares in Germany, thus continuing a trend that has been observable for roughly two years now.

Import demand broadly based

Imports rose steeply in the second quarter of 2017 after adjustment for seasonal variations. The increase was driven by strong domestic demand as well as by the rise in exports, as the exported products contain a large share of imported intermediate goods. In terms of value, the increase was not quite as sizeable. This was due to energy prices, which declined quite significantly during the reporting period. In re-

gional terms, non-euro area countries – according to the figures available up to May – benefited in particular from the strong demand for imports. By contrast, the sharp rise in imports from the euro area witnessed in the previous quarter gradually levelled off. The value of imports of Chinese products, which rose quite considerably in the second quarter, stood out in particular. Japanese products were also sought after. Demand for goods from the United States was stagnating, however. Imports from the United Kingdom failed to maintain their upward movement of the first quarter and even posted a marked decline. The value of imports from Russia also fell, probably as a result of the cheaper energy imports towards the end of the period under review.

■ Sectoral trends

Industrial output in Germany in the second quarter of 2017 was able to build on the marked increase in its pace of growth since the beginning of the year. In quarter-on-quarter terms, industrial output recorded a further sharp seasonally adjusted rise following the rather muted increase of recent years. Manufacturers of computers, electronic and optical products benefited particularly strongly from the buoyant economic activity, while growth in the mechanical engineering sector tended to be modest. All in all, manufacturers of capital goods were able to expand their production by roughly the same amount as consumer goods manufacturers. The increase was somewhat higher still in the case of intermediate goods.

Strong growth in industrial output

According to Ifo Institute data, the level of capacity utilisation of tangible fixed assets in manufacturing, which was already higher than average, went up significantly and reached its highest level in almost a decade (86½%). Producers of capital goods reported a marked increase in capacity utilisation, whereas it declined slightly in the intermediate and consumer goods industry.

Further rise in industrial capacity utilisation

Boom in the construction sector still holding strong

The construction sector is still experiencing a boom. Construction output in the second quarter of 2017 showed strong growth on the quarter after adjustment for seasonal variations. While output in the finishing trades contracted slightly, it showed very strong growth in the main construction sector. Here, building construction and civil engineering grew at similarly strong rates. According to the Federal Statistical Office, however, the high rate of growth in the main construction sector is to be seen against the backdrop of the exceptionally sharp expansion at the beginning of the year in the number of construction firms required to report, which also had a positive impact on the result of the second quarter.³

Services sector driven by strong industrial activity

The services sectors are also likely to have expanded again significantly overall in the second quarter. Price-adjusted wholesale sales increased again sharply owing to buoyant industrial activity. In line with this, the assessment of the business situation in this sector has, according to the Ifo Institute, meanwhile reached its highest level since 1991. Retail trade (excluding motor vehicles) was also flourishing. By contrast, motor vehicle sales gained little momentum. According to the figures available up to May, motor vehicle sales were down slightly following their fairly strong result in the previous quarter, whereas the number of new passenger car registrations showed a further increase. Other services, excluding trade, are likely to have undergone a marked expansion in the second quarter as well after their strong upward movement in the first quarter. Enterprises in these sectors recently rated their business situation more positively than at any other time since records began.

³ Although the adjustment to the reporting group was already made at the beginning of 2017, the fact that the increase in the number of hours worked, and thus also in output, is concentrated on February is – according to the Federal Statistical Office – “for technical reasons” resulting from the way that data are collected. For more information, see Federal Statistical Office, Anpassungen beim Produktionsindex für das Bauhauptgewerbe, May 2017.

Demand for industrial goods and construction work

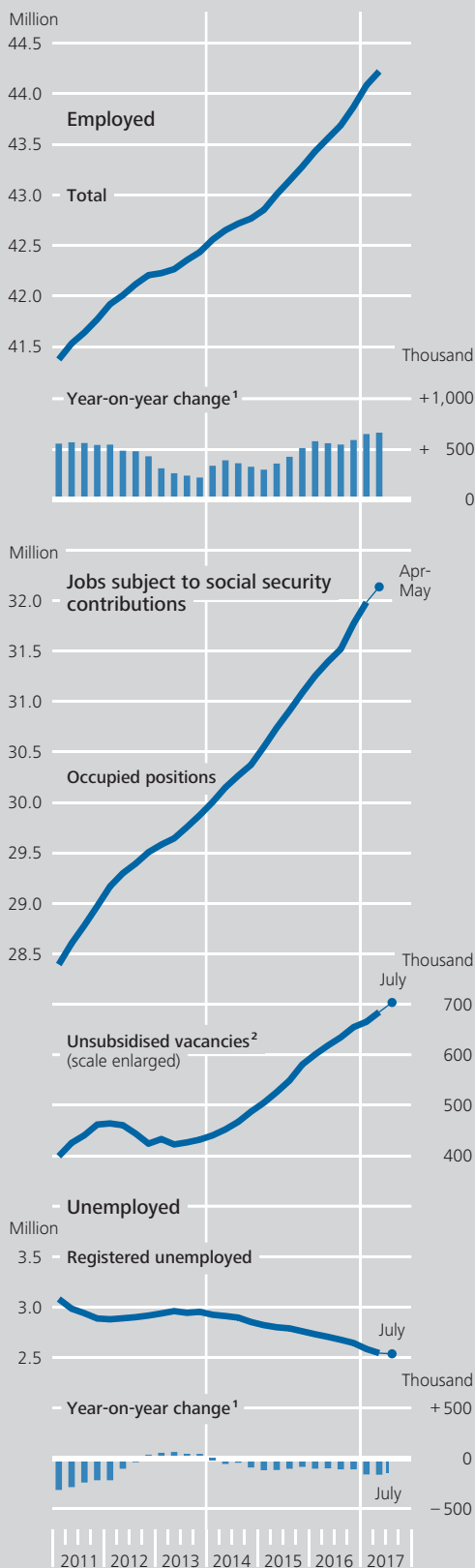
Volume, 2010 = 100, seasonally adjusted, quarterly



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

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.

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Labour market

In the second quarter, the situation in the labour market remained very favourable. Employment rose sharply, even though it was not possible to maintain the extremely rapid pace of growth seen in the final quarter of 2016 and the first quarter of 2017. This positive development in employment continued to be driven mainly by the creation of new jobs subject to social security contributions. As in previous quarters, however, there was a contraction in the low-paid part-time employment segment as well as in the number of self-employed persons. Registered unemployment fell significantly in quarter-on-quarter terms. The outlook for the next few months remains upbeat.

Labour market: situation and outlook still very buoyant

The seasonally adjusted number of persons in work in Germany rose by 138,000, or 0.3%, in the second quarter of 2017. Although this increase was still strong, it was nonetheless more moderate than in the first quarter (+0.5%). This is likely to have been due, at least in part, to the comparatively minor weather-related restrictions in the winter and the particularly early spring pick-up, which began as soon as the first quarter. Employment subject to social security contributions, which is the main driver of overall employment, was also growing more moderately of late. According to initial estimates by the Federal Employment Agency for April and May, employment subject to social security contributions was 0.4% higher than the average of the winter months.

Gratifying rise in employment in Q2

Employment growth was broadly based across all sectors. The only exceptions here were the financial and insurance industries, which are still undergoing a process of adjustment, and, over the past few months, also temporary agency employment. The latter could be a response to legislative changes, as a number of amendments to the Act on Labour Leasing (*Arbeitnehmerüberlassungsgesetz*) came into force on 1 April 2017. These included regulations on the maximum period of labour leasing and the implementation of the equal pay prin-

Employment growth broadly based across sectors

principle.⁴ The legal provisions can, however, be modified by means of collective labour agreements. Answering the question of the extent to which temporary agency work, as a particularly flexible labour market segment, will be hampered by the new regulations will depend on how employment in this sector continues to develop. The greatest increase in jobs subject to social security contributions was in business-related services (excluding temporary agency employment) and in the health and social work sector, as well as in the information and communication sector. By contrast, there was a rather average increase in the manufacturing and construction sectors. In view of the favourable orders situation in these sectors, a lack of suitably qualified workers might possibly have been the reason why employment was not expanded further.

Immigration supports employment growth

Employment was supported throughout the reporting period by strong immigration. The number of non-German nationals in jobs subject to social security contributions rose by 331,000 on the same month last year, which itself corresponds to almost half of the total increase. The east European EU member states were still the most significant region of origin. There was also a substantial year-on-year rise of 50,000 in the number of employees subject to social security contributions from the eight most significant countries of origin of asylum seekers. This represented an increase of as much as 51% over the past 12 months.⁵

Further significant decline in unemployment

Registered unemployment fell significantly in the second quarter of 2017 in seasonally adjusted terms. On an average of the reporting period, the registered unemployment figure was 40,000 lower than in the first quarter. The unemployment rate contracted by as much as 0.2 percentage point to 5.7%.⁶ The unemployment figure showed a further fall in July. The positive underlying cyclical trend is, however, masked somewhat by the fact that more persons were registered as unemployed in the context of forced migration (+44,000 in July compared with the same month last year).

According to the leading labour market indicators, employment is likely to expand over the next few months to much the same extent as the period under review. The Ifo employment barometer and the labour market barometer of the Institute for Employment Research (IAB) both remain stable at a very high level, and the Federal Employment Agency's BA-X job index is climbing from one record high to another. 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 or even declining. There has been a particularly strong increase in the number of vacancies in manufacturing and in business-related services. This is a further indication that it is the labour supply and not the demand for labour which is restricting employment growth in some sectors. The unemployment subcomponent of the IAB labour market barometer is still above the neutral threshold. The IAB expects that, in the coming months, refugees will enter the labour market in growing numbers after finishing their integration courses and that registered unemployment could thus show a smaller decline than that seen recently.⁷

Positive employment developments likely to continue, but decline in unemployment at a slower pace

■ Wages and prices

Notwithstanding the positive labour market situation and the favourable economic situ-

⁴ With the legislative amendment, a maximum period of 18 months was introduced for the leasing of labour to other firms, after which, temporary workers must be taken on as regular employees if they are to continue working for the firm. Moreover, after no later than nine months, temporary workers are to receive the same salary as comparable regular employees.

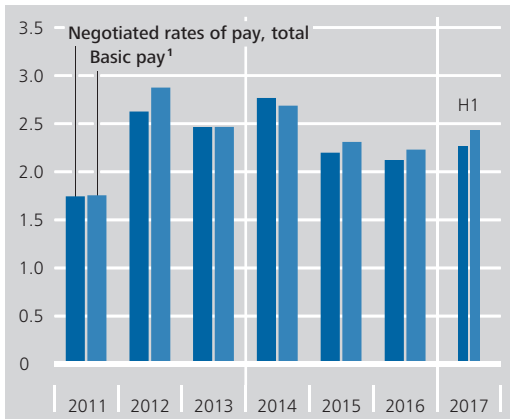
⁵ See Federal Employment Agency, Statistik/Arbeitsmarktberichterstattung (2017): Migrations-Monitor Arbeitsmarkt – Eckwerte Deutschland (July). The Middle East countries of Syria, Iraq, Iran, Afghanistan and Pakistan, as well as the African countries of Eritrea, Nigeria and Somalia, are classed as being among the most significant countries of origin of asylum seekers.

⁶ One factor in this development was that the Federal Employment Agency adjusted the calculation of the unemployment rate, as is usual in the second quarter, and, in this connection, the labour force in the denominator was increased significantly.

⁷ See the IAB press release of 27 July 2017.

Negotiated rates of pay

Year-on-year percentage change, on monthly basis



¹ Excluding additional benefits and lump-sum payments (eg holiday pay, bonuses).
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Only moderate wage growth in spite of very favour labour market

ation, wage growth in the second quarter of the year remained moderate. In the second quarter of 2017, negotiated wage rates including additional benefits and one-off payments were up by only 2.1% on the year and were thus distinctly weaker than in the first quarter. By contrast, after adjustment for special factors, the increase in basic negotiated rates of pay, at 2.4%, almost matched that in the previous quarter.⁸ What was striking in this context was the smaller growth in the services industries, which was clearly below the larger increase in industry. Months with a pay freeze agreed in recent pay negotiations in the larger industries and the low phased increases deriving from agreements in the previous year are leaving their mark on wage dynamics in the services sector. The rise in actual earnings may have been somewhat more pronounced than the increase in negotiated rates of pay.

Wage agreements with mainly moderate wage growth so far

Recent pay agreements in the services sector do not point to distinctly stronger wage growth, either. The wage increases agreed in the wholesale sector and foreign trade as well as in the initial pay settlement in the retail sector were moderate at an annualised figure of just over 2%. It was only in the automotive industry that a somewhat stronger increase of just over 2½% was agreed.

In the upcoming wage negotiations, most of which will affect the services sector, the social partners in some industries will not just be deliberating on higher wages, but also addressing other aspects such as the implications of digitalisation or enhanced arrangements for making working hours more flexible. Such components can increase labour costs directly or indirectly but, viewed in isolation, are likely to at least dampen the agreed rise in negotiated wages.

Wage bargaining also shaped by other components in addition to pay

The second quarter of 2017 saw a further rise in consumer prices as measured by the Harmonised Index of Consumer Prices (HICP). The quarter-on-quarter increase, at a seasonally adjusted 0.3%, was not as marked as in the previous quarter (0.5%), however. This was due chiefly to falling energy prices on the back of crude oil prices that were lower in euro terms. Moreover, there was no further increase in food prices. By contrast, prices excluding energy and food were accelerating more noticeably than before. The prices of services, in particular, were going up more strongly again, after upward pressure on prices had been eased somewhat at the beginning of the year by the latest reform of long-term care services. The continuing marked increase in rents played a part in this. Prices of industrial goods (excluding energy) were rising at roughly the same pace as in the first quarter. In this respect, there is likely to have been a time lag in the impact of the depreciation of the euro in the final quarter of 2016 and the first quarter of 2017.

Significant rise in consumer prices excluding energy and food in Q2

The price differential, as measured by the HICP, narrowed overall from 1.9% to 1.6% in year-on-year terms.⁹ This was also due in part to a base effect arising from the steep rise in energy prices in the second quarter of 2016. If food and energy are excluded, however, the annual

Core inflation rate above long-term average in year-on-year terms

⁸ In arithmetical terms, one-off and special payments across much of the production sector in the second quarter of 2016 result in negative base effects in the annual rate of change for the second quarter of 2017.

⁹ The annual figure as measured by the national consumer price index (CPI) fell from +1.9% to +1.7%.

rate went up quite significantly from 1.0% to 1.4%, which – given above-average aggregate capacity utilisation – was above its long-term average of 1.0%. The increase is likely to be slightly overstated as, unlike in 2016, Easter fell in the second quarter this year and there was a quite clear rise in the prices of clothing and footwear as well as travel services, which are often subject to strong fluctuations. Even if these volatile goods and services are excluded, however, the average rate of inflation at the end of the period under review was above its longer-term average.

Further clear price rise in July

After adjustment for seasonal variations, prices in July were clearly up on the month. The decline in crude oil prices in June was still having a slight impact on consumer prices for energy. By contrast, food prices were going up again. Prices of industrial goods (excluding energy) were slightly up on the month and prices of services were, in fact, quite substantially higher than in the previous month on account of travel services. Annual inflation stood at 1.5% in June in terms of both headline inflation and inflation excluding energy and food.¹⁰

Core inflation likely to rise gradually in coming months

Headline inflation is likely to be characterised by volatility in the coming months, but the core rate is likely to accelerate gradually. This is mainly due to the very upbeat economic situation in Germany. Domestic producer prices for all goods excluding energy were increased in the second quarter, too. By contrast, foreign price pressure is likely to diminish. Import prices at the end of the period under review fell overall as well as when excluding energy. This reflects mainly the recent appreciation of the euro, which is likely to increasingly feed through to consumer prices in the period ahead.

■ Orders received and outlook

Economic activity likely to remain buoyant in Q3

The strong economic growth in the German economy is expected to continue in the third quarter. Industrial output is likely to go on playing a major role, sustained by a considerable

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.

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expansion in exports. With sentiment in manufacturing at an all-time high, the robust orders situation and the large stock of orders that is still being processed suggest that industrial output will increase significantly in the current quarter, too. According to the Ifo Institute, the debate on imposing bans on older diesel cars in some German cities has so far had hardly any effect on sentiment among enterprises in the automotive sector. This may, however, also be due to the fact that the latest survey was already largely complete before the court in

¹⁰ Annual headline CPI inflation rose from +1.6% to +1.7%.

Business situation and expectations for trade and industry*

2005 = 100, seasonally adjusted, log scale



Source: Ifo Institute. * Includes the manufacturing, main construction and wholesale and retail trade sectors.

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Stuttgart backed the bans and before anti-trust complaints were made against a number of car manufacturers.¹¹ It therefore remains to be seen how events unfold. The favourable sales outlook and increasing manufacturing capacity utilisation are also likely to ensure the continuing buoyancy of business investment. Business-related services should likewise benefit from the ongoing favourable level of industrial activity. By contrast, after very strong growth of late, recent order book developments indicate that the construction sector might generate significantly fewer stimuli for aggregate economic activity. The labour market environment and the outlook for consumers' incomes should also remain favourable over the summer months, however, and continue to bolster private consumption.

Sentiment in the German economy is distinctly ebullient. Enterprises estimate the current business situation in particular as extremely favourable. In fact, the assessment of the current situation in both the manufacturing sector and the construction industry reached new record highs, according to the Ifo Institute. This was also the case for services excluding retail trade. Although business expectations fell short of their peak levels, they were nevertheless at a high level in all sectors. Furthermore, bearing in mind that the expectations are to be viewed in

the context of the excellent business situation, the latest results suggest that the buoyant economic activity will continue.

Industrial orders were also signalling a steep rise in economic output. In the second quarter of 2017, they were up significantly on the quarter, although relatively few large orders were received. Excluding such orders, there was markedly stronger growth in the inflow of new orders. This new impetus is therefore likely to be felt in the near future. In regional terms, demand from abroad was dominant. There was a strong inflow of orders from the euro area in particular. By contrast, the volume of orders from non-euro area countries suffered from a lack of large contracts and remained at the same level as in the previous quarter. Growth in domestic orders was relatively moderate, which meant that the extremely high level of the final quarter of 2016 was not yet exceeded again. Survey indicators also paint a favourable picture of the orders situation in German industry. According to the Ifo Institute, for example, the last time enterprises made such an optimistic assessment of their order books was in 2011. In line with this, the reach of the order books was, in fact, at its highest level for almost a decade.

The outlook for the construction sector is still more than averagely favourable for the third quarter of 2017, although this sector is likely to have made a smaller contribution to aggregate growth than in the recent past. In April and May – statistics are available up to then – new orders in the main construction area were considerably down on the very strong first quarter of 2017. Major stimuli were provided only by public building construction. On the other hand, the inflow of orders in other areas, and particularly in residential construction, declined considerably. According to the Ifo Institute, there was also a contraction in the reach of the

Quite substantial new orders despite fewer large orders

Peak of the construction boom reached?

Ebullient sentiment in German economy

¹¹ See the Ifo Institute, ifo Konjunktur-Perspektiven, July 2017, p 1.

order books in the main construction sector to roughly the level seen in mid-2016.

Private consumption is likely to have remained a sound pillar of the economy in the third quarter, too. In the light of the favourable labour market environment and continuing positive income growth, households' spending is likely to

have risen in the third quarter of 2017 as well. According to the consumer climate index of the Gesellschaft für Konsumforschung (GfK), consumer sentiment is at its highest level for one-and-a-half decades. Despite the recent more intense debate on pollution from older diesel car emissions, consumers' propensity to purchase is also not far from its record level.

Consumption likely to be sound pillar of economy in third quarter, too