

Economic conditions in Germany

Macroeconomic situation

Very moderate economic growth in summer 2014 ...

Economic output in Germany rose only very moderately in the third quarter of 2014. According to the Federal Statistical Office's flash estimate, real GDP edged up by just 0.1% on the preceding three-month period in seasonal and calendar-adjusted terms following a first quarter that had been boosted by special factors (0.8%) with a subsequent countermovement in the second quarter (0.1%).¹ The underlying growth path of the German economy has therefore been flattening off since the beginning of the year. In the reporting period, in particular, the slackening momentum was more pronounced than was implied by final demand. Aggregate capacity utilisation remained within normal bounds.

... due to cyclical cooling in the production sector

This cyclical cooling emanated from the production sector. Industrial orders have not been growing since the beginning of the year and business sentiment has deteriorated perceptibly. Industry was already scaling back its output slightly in the third quarter in anticipation of slackening business, even though industrial exports both within and outside the euro area showed a further increase. Following the weather-induced ups and downs in the first half of the year, the construction sector failed to maintain the heightened level of activity of 2013. By contrast, business activity in the consumption-related service sectors fared better. A key part in this was played by the positive sentiment of households, which was boosted by strong income growth and the persistently favourable labour market situation.

Clear increase in exports of goods

German firms' export business was significantly better in the third quarter of 2014 than it had been in the second quarter. This contrasts

somewhat with the weak production data and export expectations, which have been scaled back since the beginning of the year. The 2½% quarter-on-quarter rise in exports of goods in price- and seasonally adjusted terms was attributable in fairly equal parts to increased exports to other euro-area countries and to non-euro-area countries. Sales rose substantially in the central and east European EU countries and in the United Kingdom and, after the sluggish activity in the second quarter, continued their earlier upward movement. Exports in Asia were likewise on a growth course, with especially dynamic growth in exports to south and east Asian emerging market economies. Exports to China, which had expanded very strongly in the previous quarter, showed only a slight increase in the summer, however. There was a further marked rise in exports to the United States. By contrast, sales in the OPEC countries declined

Overall output

2010 = 100, price- and seasonally adjusted



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

¹ The quarterly rates of change of the first and second quarters were revised upwards by 0.1 percentage point in each case.

Underlying trends in foreign trade

Seasonally adjusted, quarterly



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

equipment. Exports of intermediate goods saw a slight rise. Moreover, exports of consumer goods were flourishing, which was due in particular to sales of pharmaceutical products.

Imports of goods in the third quarter largely offset the losses sustained in the preceding three-month period. In price- and seasonally adjusted terms, there was an increase of 1¼% on the second quarter, which had seen a fall of ½%. Imports of capital goods performed relatively unfavourably. Other transport equipment played a major role in this context. Moreover, German enterprises' continuing hesitant propensity to invest was also making itself felt. The detailed figures, which are currently available only up to August, show that purchases of machinery from foreign producers were down significantly on the quarter, with sales of motor vehicles stagnating. The reporting period is likely to have seen an overall increase in imports of information and communication technology (ICT) products and electrical equipment. There is also likely to have been a rise in imports of intermediate and consumer goods.

Imports almost made up for previous quarter's losses

Investment in machinery and equipment in the second and third quarters failed to continue its tendency towards recovery that began to emerge in the final quarter of 2013 and the first quarter of this year. Enterprises anticipate that demand can be comfortably met using the available domestic capacities. The purchase of moveable fixed assets is thus primarily in connection with replacement and modernisation projects. The relevant short-term indicators confirm the finding that enterprises are currently exercising caution in terms of their investment behaviour. During the summer months, the increase in domestic sales of machinery and other equipment contrasted with weak imports in this product group. Although there were distinctly more new car registrations by commercial customers, new commercial vehicle registrations were stagnating during the period under review.

Investment in machinery and equipment still lacking momentum

considerably, albeit following a sharp increase in the second quarter. There was an acceleration of the downward trend in trade with Russia observed over the past two years.

Broad-based expansion in the range of exports

The expansion in exports covered a wide range of goods. There were, admittedly, sectors where growth was negative, above all in capital goods. The automotive industry suffered a setback following its export successes in the second quarter. Furthermore, sales of machinery decreased. By contrast, exports of other transport equipment recorded a sharp increase. There were also more exports of computers, electronic and optical products and electrical

*Lack of stimuli
 in construction
 investment*

Seasonally adjusted construction output declined somewhat in the third quarter. Following a steep decline in the previous quarter, which is to be seen chiefly as a reaction to weather-related strongly heightened activity in the first quarter, this clearly points to a slowdown in construction output. This interpretation is also corroborated by the fact that utilisation in the main construction sector in the second and third quarters no longer matched the record highs of the preceding 12-month period. A certain heterogeneity across the construction sub-sectors may be noted, however. Tendencies towards an easing of the situation are likely to have been related primarily to construction work in the commercial and public sectors. Nevertheless, housing construction, too, is showing a slackening pace of growth.

*Further expansion
 of private
 consumption*

According to Federal Statistical Office data, private consumption expanded substantially in the third quarter of 2014. This is in line with the market research institution *Gesellschaft für Konsumforschung* (GfK) rating the consumer climate more favourably again. Households' keenness to consume remained particularly pronounced despite dropping off slightly. The main factors here were the continuing positive situation on the labour market and strong wage increases. This is consistent with the higher number of car registrations by households and with indicators for the retail sector. In particular, retailers continued to take an optimistic view of their business situation.

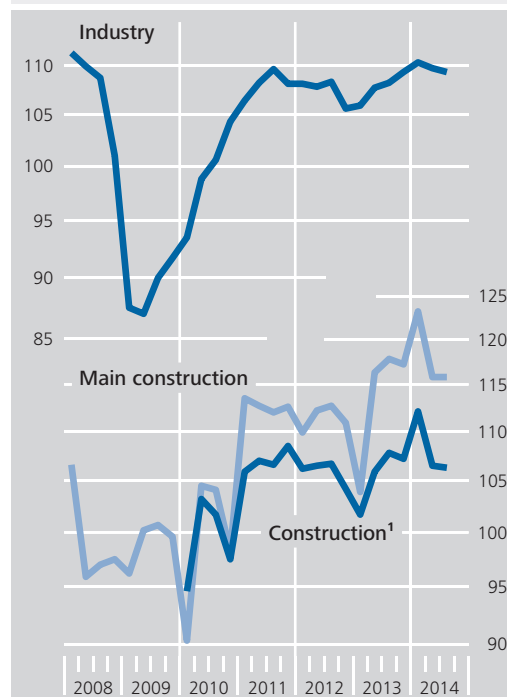
■ Sectoral trends

*Further slight fall
 in industrial
 output ...*

In the third quarter of 2014, industrial production declined by a seasonally adjusted ¼% on the quarter. The decline was somewhat smaller than in the second quarter (-½%). Unlike in the second quarter, the dampening effects of holiday and bridge days did not play a significant part in terms of the quarter-on-quarter figure. The summer months presented an entirely different picture with regard to the quarterly pattern of industrial output, which was marked by

Output in industry and in construction

2010 = 100, seasonally adjusted, quarterly, log scale



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

considerable fluctuations due to the extremely late start to school holidays in many federal states. All in all, the slight downward movement in industrial output since the second quarter is a reflection of the underlying trend in incoming orders that set in at the beginning of the year, which reveals no momentum.

Output in major sectors of industry was marked by considerable differences in the third quarter. Overall output was curbed by the automotive industry, which cut back its production (-¾%). Capital goods production was nevertheless up by ¼% on the second quarter. Mechanical engineering recorded a steep rise (+3¼%) after contracting in the two preceding quarters. In addition, output increased in the computers, electronic and optical products sector as well as in other transport equipment. The production of intermediate goods showed a marked overall decline (-¾%). Manufacture of metal products contracted again, while the chemicals industry recorded a rise. In the period under re-

... with considerable differences between the sectors of industry ...

view, output of consumer goods was down slightly (-1/2%) on the second quarter.

... also in view of capacity utilisation

Looking at manufacturing capacity utilisation, as reported by the Ifo Institute, when broken down into main industrial groupings, the intermediate goods sector appears to be in a somewhat better cyclical position than the capital goods sector at the start of the fourth quarter. In the intermediate goods sector, the lead over the multi-year average was maintained, while producers of vehicles, machinery and other equipment saw an overall decline back to normal sectoral capacity utilisation.

Lack of momentum in construction output, energy production down slightly

In the period under review, seasonally adjusted construction output just about maintained the level of the previous quarter (-1/4%). Main construction output remained unchanged overall in seasonally adjusted terms. Building construction and civil engineering practically showed a sideways movement. Provisional data, which are fairly prone to revision, indicate a decline of 1/2% in finishing trades output. Energy production recorded a slight seasonally adjusted decrease of 1/4% in the third quarter.

Services sector still on growth path

The services industries are likely to have expanded again overall in the period under review. Nevertheless, it was mainly in the service sectors related to industry and construction that the lack of stimuli from the production sector was making itself felt. The decline in the mileage of domestic heavy goods vehicles on toll roads, for example, is an indication that business in the transport sector was impaired. In keeping with this picture, the wholesale trade recorded a quarter-on-quarter decline in sales after seasonal adjustment. By contrast, service providers primarily geared to consumption benefited from the continued markedly positive consumer sentiment. Sales by motor vehicle traders showed a distinct increase and retail sales almost held up at the level of the second quarter. The hotel and restaurant sector is likely to have recorded a significant increase in turnover.

Employment and labour market

The ongoing upturn on the labour market has so far not been dented by subdued growth in the economy. There was a steep rise in employment of 81,000, or 0.2%, in the third quarter of 2014, even though this was somewhat weaker than in the second quarter (+128,000). Unemployment tended to move sidewise. The rising demand for labour is still being largely covered by immigration.

Stable employment growth with stagnating unemployment

Growth in employment in the third quarter was once again attributable solely to the increase in regular jobs subject to social security contributions, while self-employment was stagnating and the number of persons employed exclusively in forms of low-paid part-time work in fact decreased slightly. After seasonal adjustment, a total of roughly 101,000 additional jobs subject to social security contributions were filled in July and August; this corresponds to an increase of 0.3% compared with the second quarter. The sectoral profile remained broadly unchanged compared with the second quarter. Employment in business-related services (excluding temporary agency employment), the health and social work sector, and hotel and restaurant services showed comparatively clear growth. There was an increase on average in the number of positions filled in manufacturing, the closely related sectors of logistics and temporary agency employment, and in the wholesale and retail trade. The construction sector did not make any contribution to employment growth, however.

Jobs subject to social security contributions growing mainly in services sector

According to the available information, the influx of workers from other European countries during the year so far seems as large as it was in 2013. By contrast, there was a considerable increase in the number of refugees and asylum

Immigration remains high

seekers.² In all probability, the migration surplus for 2014 as a whole is again likely to be clearly higher than in the previous year (437,000 persons), but is likely to have a smaller impact on the labour market. There has been a distinct increase in immigration from Romania and Bulgaria³ owing to the free movement of workers since the beginning of 2014. Immigration from the eight central and east European countries that joined the EU in 2004 is still substantial, but has declined slightly compared with 2013. Much the same applies to three of the four south European periphery countries. It is only from Italy that more immigrants are expected in the current year on balance than in 2013. Whereas immigration from EU countries directly strengthens the potential labour force, this is not the case for asylum seekers and refugees, as they are not generally granted immediate access to the labour market.

Almost no change in registered unemployment

The seasonally adjusted number of persons registered as unemployed has been hovering at around 2.9 million for six months. On an average of the third quarter, slightly more persons were registered as unemployed than in the preceding three-month period. This can be explained by the timing of this year's school holidays, which stretched further into September than in other years. This meant that enterprises' increased recruitment activity linked to the end of the holidays did not have an impact until October, when unemployment showed a marked decline of 22,000. The unemployment rate remained at 6.7% throughout.

The labour market is likely to remain stable regardless of the gloomier cyclical outlook. The

² The number of initial applications for asylum rose from 65,000 in 2012 to 110,000 last year. 136,000 initial applications for asylum were made in the Federal Republic of Germany in the first ten months of this year, with just under one-quarter of these submitted by persons from Syria.

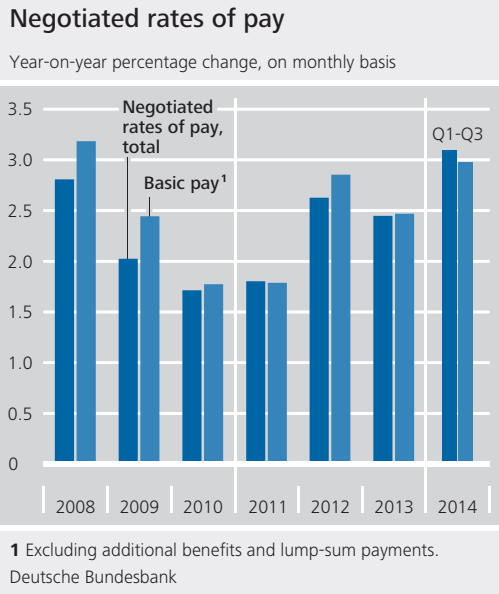
³ According to the Central Register of Foreign Nationals, the number of nationals from these countries registered in Germany showed an annual increase of 114,000 in September. This means that immigration from this region is likely to be more than one-third higher than in the previous year.

Labour market

Seasonally adjusted, quarterly



Source of unadjusted figures: Federal Statistical Office and Federal Employment Agency. ¹ Not seasonally adjusted. ² Excluding seasonal jobs and jobs located abroad. ³ From May 2009, unemployed excluding persons newly registered on the books of private employment agencies.



Wages and prices

The increase in negotiated rates of pay in the second half of the year has so far not been quite as high as it was in the first six months of the year. Collective wages and salaries, including one-off payments and fringe benefits, went up by 2.8% year-on-year in the third quarter of 2014, after rising by 3.3% in the second quarter. Growth in basic rates of pay declined from 3.4% to 2.9%. One of the main reasons for this slower increase was that, in a number of longer-running collective wage settlements, the second, smaller rise was paid out. Secondly, the wage agreements concluded in the later stages of this year's pay round no longer provide for rises that are as substantial as those in settlements reached at the beginning of the year. However, industry-specific factors probably also made themselves felt in the most recent pay agreements of the cooperative banks and the west German textile and clothing industry with volumes of no more than around 2% converted to an annual basis.

Negotiated rates of pay grew less sharply in Q3 2014 than in H1

Further rise in employment likely

Ifo employment barometer, which provides information on the employment plans of trade and industry and business-related services over the coming three months, continues to point to an expansion. This can also be seen from the September DIHK survey, even though there has been a decline in the previously fairly high percentage of enterprises planning to increase their staff numbers over the next 12 months. With regard to unemployment, leading indicators suggest a sideways movement. The IAB labour market barometer, which is based on surveys of the managers of all the local employment agencies, just surpassed the neutral threshold in October.

Growth in vacancies probably not solely for cyclical reasons

The Federal Employment Agency's BA-X job index continued to improve during the summer and rose to its highest level for more than two years. This is due to a marked increase in job vacancies reported to the Federal Labour Agency. However, following the introduction of legislation from 1 July 2014 allowing long-term contributors to the statutory pension insurance system to retire early at the age of 63 and draw a full pension, this movement cannot be interpreted as being purely cyclical in nature. It is more likely to indicate difficulties in filling vacancies following the early retirement of experienced skilled professionals.

Overall price developments in Germany were trending moderately upwards in the third quarter of 2014. With the exception of energy, external price pressure eased on the back of the euro's depreciation, so that domestically generated cost trends are gaining in importance.

Subdued upward price trend

With the exception of energy, seasonally adjusted prices largely moved upwards at the upstream stages of the economy in the third quarter compared with the preceding three-month period. This applies equally to intermediate, capital and consumer goods at both the import and the domestic producer levels. In the case of imports, this brought a halt to a downward trend caused mainly by the euro's appreciation between mid-2012 to early 2014. The decline in the domestic producer prices of consumer goods, which does not appear to fit into this pattern, was driven by a marked reduction in the price of dairy products in September. By contrast, energy prices contracted clearly in the third quarter as a result of declin-

No further decline in prices excluding energy at upstream stages of the economy

ing crude oil prices, although the depreciation of the euro had a mitigating effect. The annual rate of change in prices at the upstream stages of the economy remained broadly negative due to the effect of energy. It declined marginally by -1.8% for the imports of goods and remained at -0.8% for domestic sales. As there was no change in export sales prices in year-on-year terms, the terms of trade showed a distinct improvement.

No further slowdown in rise in construction prices, tendencies towards easing on the housing market

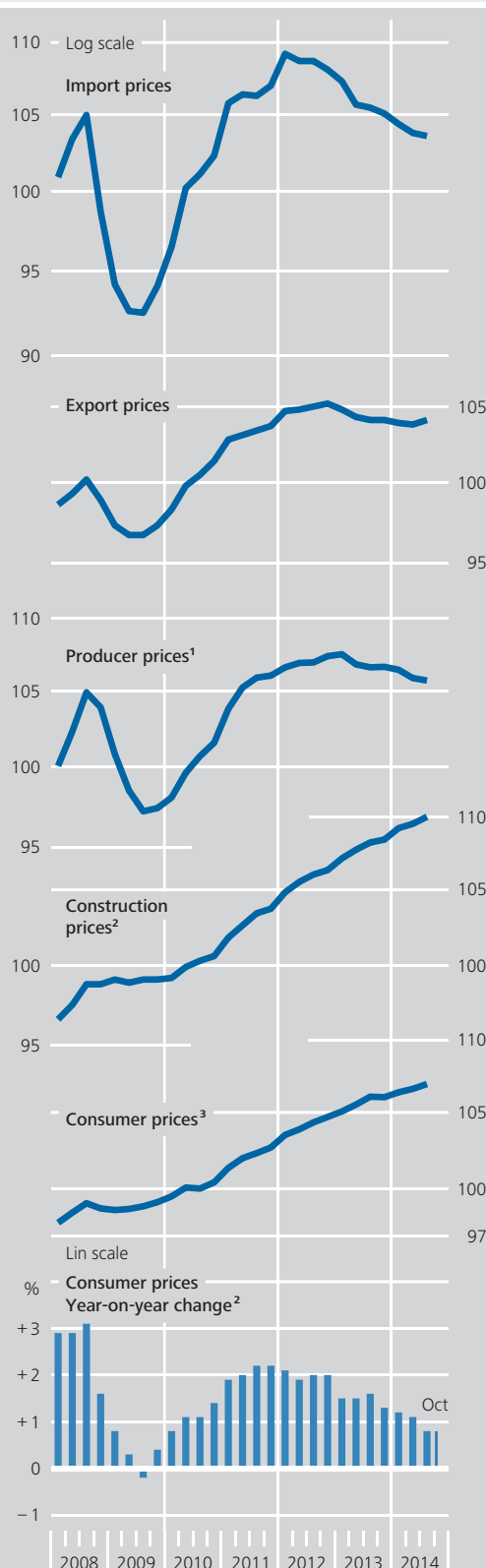
The easing of price inflation in construction services continued in the third quarter. The year-on-year rate persisted at 1.7%. The rate was somewhat higher for the finishing trades than it was for structural work, with price reductions for cement and concrete likely to have played a part in this. The cooling of the, in some instances, overheated regional property markets is also revealed in the price data. According to data from BulwienGesa AG, housing prices in the third quarter rose by 5¾% on the year in the seven big cities, compared with 7% in the first half of the year and as much as 9% in 2013. The relatively moderate rise in prices for owner-occupied housing over the course of the year so far is mainly due to the slowdown in price rises in urban housing markets.

Subdued rise in consumer prices continues

Consumer price inflation remained muted in the summer. The quarter-on-quarter rate, at a seasonally adjusted 0.3%, was in fact somewhat higher than in the second quarter. The prices of all the larger components, with the exception of energy, were moving upwards. There was a fairly sharp increase in food prices, mainly for fruit and vegetables as a result of the poor weather in August. The sub-index for industrial goods (excluding energy) also showed a marked rise, due, among other things, to the increase in additional charges for numerous medicines from July onwards. The upward trend in services prices and housing rents remained largely unchanged. Only energy prices declined distinctly as a result of the easing in crude oil prices.

Import, export, producer, construction and consumer prices

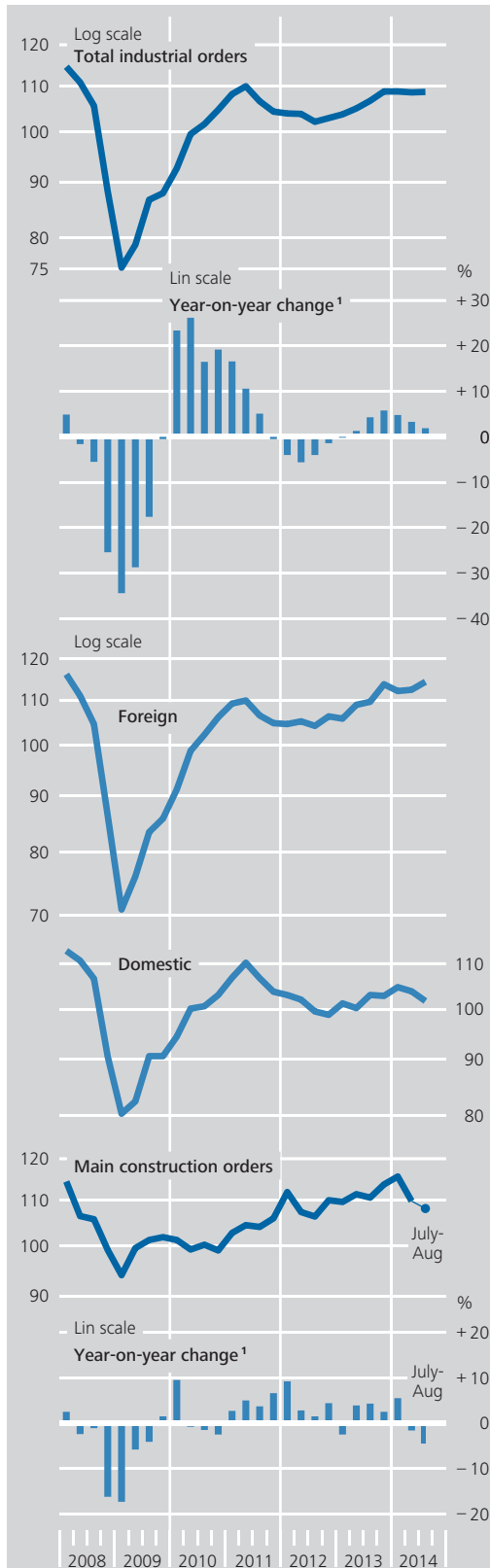
2010 = 100, seasonally adjusted, quarterly



Source of unadjusted figures: Federal Statistical Office. **1** Producer price index for industrial products in domestic sales. **2** Not seasonally adjusted. **3** National consumer price index. Deutsche Bundesbank

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

In spite of this broadly-based upward movement, the annual rates of the national consumer price index (CPI) and of the Harmonised Index of Consumer Prices (HICP) went down slightly to 0.8%. A contributing factor was that, unlike this year, energy went up in the third quarter of 2013. Excluding energy, consumer prices were 1.3% up on the year in the third quarter, which is moderate in view of the accelerated rise in unit labour costs. One likely reason for this is that, owing to the comparative rent system, there is a major time lag before increases in rents for new lettings affect existing rents, which dominate the consumer price index. Another is that lower prices in important holiday destinations are also reflected in the German consumer price index through the channel of package holidays.

In October, seasonally adjusted consumer prices in Germany saw a marked month-on-month fall (0.2%) for the first time in a long while. This decrease was due to a clear lowering of prices of refined petroleum products as a result of the declining crude oil prices. In addition, prices for industrial goods (excluding energy) were lower due to mid-season sales in clothing. Such sales of autumn goods used not to be common in Germany. These price-dampening effects more than offset the price increases for services and the slightly faster rise in housing rents. Nevertheless, the annual rate of the national consumer price index (CPI) remained unchanged at 0.8% and annual HICP inflation went down only slightly to 0.7%, since there had been steep price reductions in energy prices in October last year.

Temporary dip in prices in October

Orders received and outlook

The further deterioration in business expectations and the stagnation of new orders point to a rather sluggish course of economic development in Germany until at least the end of 2014. Although global demand for goods is continuing to expand, it currently lacks major stimuli. In addition, no marked recovery in im-

Economy lacking momentum in coming winter

portant euro-area partner countries has yet materialised. Nonetheless, other external factors, such as the euro's considerable depreciation and the sharp fall in oil prices, could gradually improve economic activity to a limited extent. Given the favourable labour market situation, high levels of immigration and marked wage growth, underlying domestic growth dynamics will receive continuing support from private consumption. In the light of increased global risks and uncertainty about the implications of some economic policy measures, there may be a time lag before the recovery in corporate investment resumes.

under review, with the slowdown in domestic demand being considerably greater than that for export orders. Following an 18-month upward movement, new orders of consumer goods underwent a quarter-on-quarter decline of 1¾% in the third quarter.

Construction activity is likely to have continued to bolster the domestic economy, although in the short term it will not match the intensity of the past year. The marked decline in permits for apartments built by private contractors since the beginning of the year is becoming increasingly apparent in the case of housing construction. The resulting slowdown did have an impact on the dynamics of demand, even though the volume of permits for housing enterprises' construction projects showed a sharp increase during the same period. Added to this is the fact that seasonally adjusted construction demand from enterprises and public institutions failed to match its level in the final quarter of 2013 and first quarter of 2014.

Construction activity less brisk than before

The current lack of impetus in industry and construction is spilling over into some services sectors. According to the Ifo business survey, business expectations in trade have likewise deteriorated. Sentiment remained very optimistic in the other services sectors, however. The German Chamber of Industry and Commerce (DIHK) survey, which is representative of a wide section of the economy, shows that 85% of enterprises do not expect business to deteriorate in the future. This is a decline of just 4 percentage points compared with the figures published at the beginning of the year and in the early summer. The ongoing labour market improvement and households' consumer sentiment are contributing to the stable overall situation in the domestic economy. Consumers appeared largely unperturbed by the deteriorating economic outlook and, until recently, were still feeling extremely positive about their income prospects and propensity to purchase.

Domestic economy stable overall

No new impetus from industrial orders

Industry has already attuned itself to more unfavourable demand conditions by cutting production. Further adjustments are possible given the deterioration in business and export expectations, which has extended over a period of more than six months now. In the third quarter, new industrial orders maintained the level of the second quarter after seasonal adjustment. However, waning demand for intermediate goods, mainly from Germany (-2¾%), but also from the euro area (-¾%), could be seen as an indication that industrial activity is likely to be relatively feeble in the coming months. By contrast, orders of inputs and intermediate goods from non-euro-area countries were clearly up (+2%) on their depressed level of the second quarter.

Major orders in shipbuilding

The tendency to weakness is less clear with regard to demand for capital goods, however. Extremely large major orders in shipbuilding played a key part in the marked 1¼% rise on the quarter overall. However, even excluding other transport equipment, the volume surpassed the peak of the current business cycle in the first quarter of 2014. This was primarily due to the fact that mechanical engineering orders continued their upward trend throughout the summer months, with stimuli from both Germany and abroad. By contrast, orders of motor vehicles saw noticeable losses in the period