

## The German economy

### Macroeconomic situation

*Slight decline in German economic output in the third quarter, mainly due to temporary one-off effects*

Economic output in Germany dipped slightly in the third quarter of 2018. According to the Federal Statistical Office's flash estimate, real gross domestic product (GDP) contracted by 0.2% in seasonal and calendar-adjusted terms as compared to the previous quarter. This decline was mainly caused by a strong temporary one-off effect in the automotive sector. Major problems in connection with the introduction of a new EU-wide standard for measuring exhaust emissions led to significant production stoppages and a steep drop in motor vehicle exports. At the same time, private consumption was temporarily absent as an important force driving the economy. This was probably due to the reduced supply of domestically produced vehicles – and potentially also the debate about a driving ban for vehicles with high emissions

levels – as well as the exceptionally hot, dry weather during the summer months. Despite these temporary one-off effects, the economic boom in Germany continues. Utilisation of aggregate production capacity remains well above average. The German economy will probably expand quite strongly again towards the end of the year.

The manufacturing sector recorded a sharp fall in output as a result of the temporary production stoppages in the automotive sector and was therefore a major factor in the decline in economic output during the third quarter. Moreover, the construction sector grew considerably more slowly than in the second quarter, when construction activity had expanded sharply. The upswing in the service industries may have continued. On the demand side, the weakness was fairly broadly based. Only investment in new machinery and equipment and in new buildings as well as, to a certain extent, government consumption expenditure provided positive momentum. Large-scale imports are likely to have been used, in part, to replenish inventories.

*Sharp fall in industrial output caused by automotive sector*

#### Overall output

2010 = 100, price and seasonally adjusted



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

German exporters' foreign business fell significantly in the third quarter of 2018 in price-adjusted terms. This was largely because of the considerable difficulties the automotive sector experienced with the introduction of the EU-wide emissions test procedure WLTP (Worldwide harmonised Light vehicles Test Procedure). Had this sector's exports not declined, exports would not have decreased slightly, they would have risen by 1% – according to data up until August. In regional terms, deliveries to euro area partner countries (by value) remained unchanged from the previous quarter overall – according to provisional seasonally adjusted figures available up to September. Exports to non-euro area countries, by contrast, fell noticeably. Exports of goods to the United Kingdom, which is still part of the EU, dropped par-

*Exports lower because of a sharp drop in automotive deliveries*

ticularly sharply, probably also as a result of extremely weak motor vehicle deliveries. In addition, German companies faced lower demand in Russia and the newly industrialised Asian economies. Business with China, meanwhile, flourished. Goods deliveries to the United States, where the economy is currently experiencing strong growth, also expanded perceptibly. The German export industry reported a considerable increase in sales to Japan and the southern and eastern Asian emerging market economies.

*Growth in business investment in machinery and equipment probably only moderate*

Given the lacklustre economy and, in particular, the weak exports in the third quarter of 2018, business investment in machinery and equipment is likely to have been moderate, particularly as the nominal sales of capital goods producers in Germany fell sharply. This was not only attributable to the automotive industry, which had to significantly lower its output in the quarter under review because of the one-off effect of the WLTP. Domestic sales in mechanical engineering and by producers of computers, electronic and optical products were also down on the previous quarter. Weak domestic sales by German manufacturers of capital goods were, however, probably more than offset by higher imports. The strong growth of commercial vehicle registrations in the third quarter could also have boosted investment activity somewhat, assuming that some of these vehicles came from inventories rather than all coming straight from the factory or from imports.

*Construction investment likely to have grown moderately*

Construction investment appears to have achieved only moderate growth during the third quarter of 2018. According to data up until August, growth in nominal sales in the main construction sector was appreciably lower than in the second quarter. Investment in commercial buildings is likely to have fallen, while private housing investment has probably risen.

*Dip in private consumption during the summer*

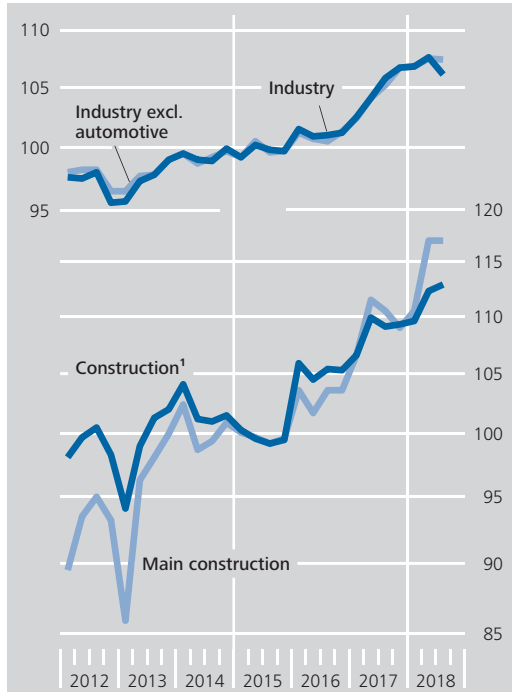
Household consumption was down on the quarter in the third quarter of 2018. The sharp increase in energy prices probably limited con-



sumers' scope for spending. Retail sales were even actually down on the previous quarter, with turnover in textiles, clothing and footwear particularly hard hit. This could be linked to the exceptionally hot and dry summer this year. By contrast, demand for electrical household appliances as well as furniture and furnishings was much higher than in the second quarter. A significant increase in sales was also recorded in online and mail order trade, which was therefore able to match the high rate of growth of the second quarter. Although restaurants and hotels probably benefited from the stable weather conditions, sales fell short of the high level of the second quarter here, too. In add-

### Output in industry and in construction

2015 = 100, seasonally adjusted, quarterly, log scale



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

ition to retail and hospitality, trade in motor vehicles is also likely to have had a negative impact on private consumption. This is probably due mainly to the introduction of the new emissions test procedure in September 2018, which was associated with temporary delivery difficulties in the automotive industry and a higher motor tax burden. For instance, registrations of new cars by households slumped in September. However, motor vehicle traders had increased the number of one-day registrations of vehicles back in August, technically rendering them second hand. It is not yet clear to what extent private demand was satisfied by dealers selling such second-hand cars. In addition to these repercussions of the new emissions test procedure, it is also possible that the mooted driving bans for vehicles with high emissions levels could have unsettled consumers and caused them to postpone buying a car.

Imports rose sharply in real terms during the third quarter of 2018. There was strong demand, in particular, for intermediate goods, which were probably used to replenish inventories given that the quarter was weak overall. In a regional breakdown, imports of goods from the euro area countries displayed particularly strong growth – according to provisional seasonally adjusted figures available up to September. However, imports from outside the euro area also expanded. A quite considerable increase in imports of goods from the United States was striking. Imports from China and Japan also displayed marked growth. The same is true of the eastern and southern Asian emerging market economies. Meanwhile, imports from the newly industrialised Asian countries were slightly down on the quarter in the reporting period. Deliveries of goods from the United Kingdom even declined very significantly. This was probably largely down to a one-off development in other transport equipment, where imports had spiked in the previous quarter before normalising in the third quarter.

*Strong import demand despite slight decline in economic activity*

### ■ Sectoral trends

Industrial output declined sharply in the third quarter of 2018. It fell 1½% on the previous quarter in seasonally adjusted terms. The main reason for the steep drop were large-scale production stoppages in the automotive industry, which were related to considerable difficulties switching to the new WLTP emissions test procedure. According to a simple mechanical calculation, this could have depressed GDP growth by an estimated 0.4 percentage point in the third quarter.<sup>1</sup> Excluding the automotive industry, industrial output remained unchanged on the quarter. Consequently, production of capital goods shrank most overall. However, the

*Industrial output sharply lower due to a slump in automotive production*

<sup>1</sup> It was assumed that the output of motor vehicles would otherwise have increased as in the previous quarters. No account was taken of negative spillover effects on other sectors via production linkages. With this in mind, the actual effects could therefore be somewhat higher.

production of intermediate goods also fell sharply. Supply chains mean that manufacturers of these goods are also likely to have been affected, at least in part, by the lower output in the automotive sector. The output of consumer goods expanded strongly, by contrast. Here, production of pharmaceutical products grew particularly strongly, probably because certain cancer treatments were launched.

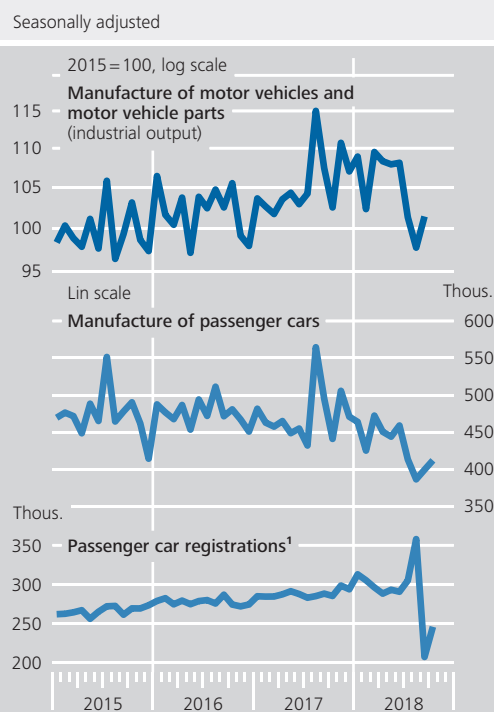
*Industrial capacity utilisation lower*

According to Ifo Institute data, capacity utilisation of tangible fixed assets in manufacturing was perceptibly lower in the third quarter than in the previous quarter. Again, the steep drop in output in the motor vehicle industry is likely to have been key. Thus, only manufacturers of capital goods reported a significant drop in capacity utilisation. Capacity utilisation in the intermediate goods sector, by contrast, remained unchanged on the quarter, whilst utilisation of production capacity in the consumer goods sector actually rose considerably.

*Construction output significantly higher*

Output growth in the construction sector slowed in the third quarter of 2018, though expansion was still perceptible, at ½% on the previous quarter. However, positive catalysts came only from the finishing trades, where output expanded considerably during the period under review. Output in the main construction sector, meanwhile, remained unchanged on the quarter. A slight increase in civil engineering construction work and a significant drop in activity in the construction of buildings balanced each other out. Nonetheless, the economic indicators suggest that the construction boom in Germany continued during the third quarter. According to the Ifo Institute, capacity utilisation in the main construction sector remained exceptionally high. Furthermore, a significant proportion of construction companies continued to complain that a lack of labour was preventing them from further expanding output. And not least, the construction boom was reflected in increasingly higher construction prices.

### Output in the automotive industry and registrations of passenger cars



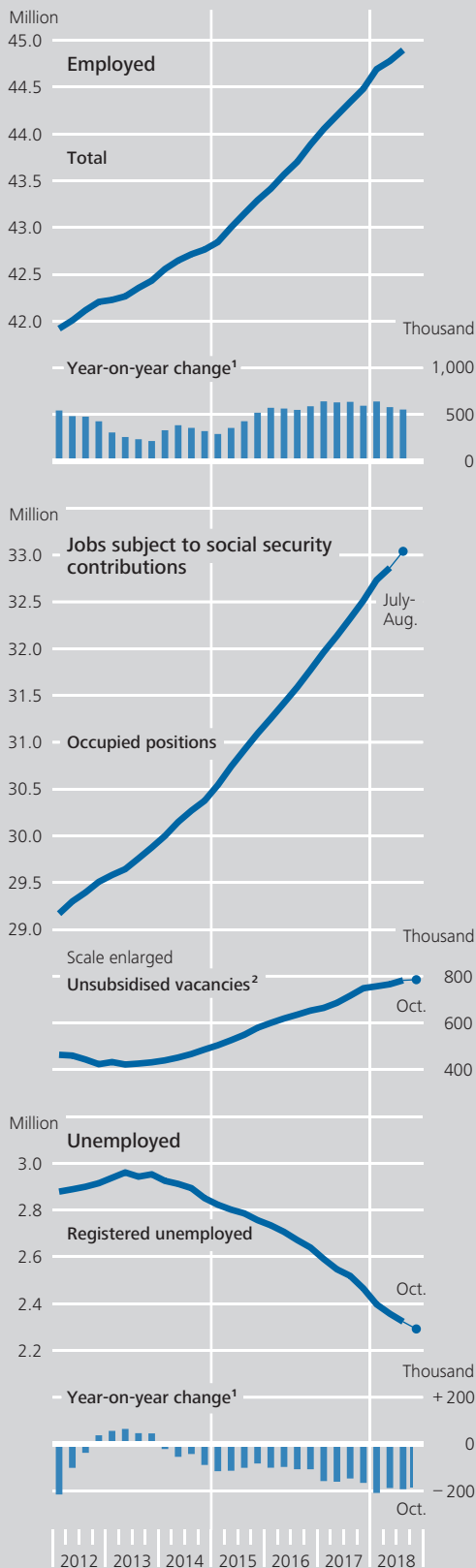
Sources of the unadjusted figures: Federal Statistical Office, Association of the German Automotive Industry (VDA). <sup>1</sup> Brand new vehicles.  
 Deutsche Bundesbank

Economic output in the service industries likely increased slightly in the third quarter of 2018. Wholesale and retail trade sales will, however, have put in a fairly muted performance, as wholesalers' business followed weak industrial output and dropped markedly in real terms. Price-adjusted retail sales were also down on the previous quarter. This is likely due to the exceptionally dry and hot weather during the summer months. And not least, sales in motor vehicles could have dropped as a result of the production stoppages in the automotive industry. However, other services sectors probably continued to benefit from favourable business developments. This is, in any case, suggested by the assessment of the business situation in this sector, which improved noticeably during the reporting period according to the Ifo Institute.

*Services sector likely expanded slightly*

## Labour market

Seasonally adjusted, quarterly



Sources of unadjusted figures: Federal Statistical Office and Federal Employment Agency. **1** Not seasonally adjusted. **2** Excluding seasonal jobs and jobs located abroad.

Deutsche Bundesbank

## Labour market

In the third quarter, too, the labour market situation was characterised by very high levels of employment and low unemployment. Employment was somewhat more buoyant again following moderate growth in the previous quarter. This was mainly due to the still fairly strong growth in jobs subject to social security contributions. Unemployment dropped noticeably in the reporting quarter from an already low level. At the same time, the already large number of vacancies continued to grow. Leading indicators show persistently high demand for labour over the next few months.

*Very high employment levels and low unemployment*

Employment growth accelerated slightly from the second to the third quarter of 2018, but was unable to match the momentum of the preceding quarters. After seasonal adjustment, an average of 118,000 more people were in work in Germany during the summer months than in the previous quarter. This translates into an increase of 0.3%. According to first estimates by the Federal Employment Agency (BA), the number of people in jobs subject to social security contributions rose by 140,000, or 0.4%, in the first two months of the reporting quarter alone compared with the average of the second quarter. In other words, the currently favourable labour market situation for employees has seen a strong expansion in jobs with full social security coverage. This is to the detriment of other forms of employment: both the number of people in low-paid part-time work and that of self-employed has been sinking considerably for some time now.

*Strong growth in jobs subject to social security contributions*

At sector level, the increase in jobs subject to social security contributions has been broad based. Business services such as IT and logistics have experienced particularly strong growth, but health and social services as well as business and support services (not including temporary agency workers) have also seen significant gains. Similarly, employment in manufacturing and construction increased perceptibly. In the finance and insurance sectors, staff cuts

*Growth broadly based across sectors, but strong decline in temporary agency work*

did not continue. Only temporary agency work, which is characterised by high fluctuation, witnessed a considerable drop in the number of jobs, as has been the case all this year to date.

*Unemployment only falling among long-term unemployed persons receiving basic welfare allowance*

The official unemployment figure continued to decline in the third quarter. On an average of the reporting period, the registered unemployment figure was 35,000 lower than in the second quarter after seasonal adjustment. The unemployment rate fell by 0.1 percentage point to 5.1%. The number of unemployed persons was down again in October. Much like in the second quarter, the positive development in the third quarter was solely attributable to a fall in the number of long-term job seekers receiving the basic welfare allowance. Unemployment covered by the statutory insurance scheme is already very low and did not fall any further.

*Growth in labour supply ...*

While enterprises' demand for labour is high, the labour supply is growing at a slower pace. The number of unemployed persons is low and the number of people who are in work but would like to increase their working hours is declining in step with unemployment. Moreover, labour market participation in Germany has risen to the highest level in Europe over the past few years and it is becoming increasingly difficult to mobilise additional members of the workforce. This is why immigration has a crucial role to play. In arithmetical terms, of the 715,000 additional jobs subject to social security contributions that existed in August 2018 compared with August 2017, only a little under half could be filled by German nationals. The gap was filled, in particular, by persons from eastern European EU Member States and from the eight main countries of origin of asylum seekers. Immigration has been clearly on the wane for quite some time now, however. Data from the Federal Statistical Office reveal that immigration to Germany was down by one-sixth on balance in 2017 compared with the previous year. According to the data available so far, the decline continued at the same pace in the first five months of the current year.

### 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

Labour market tightness is therefore intensifying. It is becoming increasingly difficult for enterprises to find suitable skilled labour. Data from the Federal Employment Agency show that the average vacancy period is 112 days at the current time, which is one month more than three years ago. In fields such as care of the elderly and plumbing/heating, vacancies remain unfilled for even longer than expected, at six months on average. The labour shortage is gearing up in other professional fields. According to the Federal Employment Agency, the unemployment rates for qualified personnel in specific careers are just under 2% for specialists and experts and less than 4% for skilled workers with vocational training.<sup>2</sup> This suggests that recruitment is being hampered by a lack of personnel.

*... lags behind increasing demand for labour*

<sup>2</sup> See Federal Employment Agency, Statistik/Arbeitsmarktberichterstattung, Berichte: Blickpunkt Arbeitsmarkt – Fachkräfteengpassanalyse, June 2018.



### Import, export, producer and consumer prices

2015 = 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

*Leading indicators suggest demand for labour will continue to grow in short term*

The relevant leading indicators suggest that enterprises' demand for labour remains exceptionally high. The number of job vacancies reported to the Federal Employment Agency is on an upward trend. However, the number of vacancies could also rise due to changes in enterprises' reporting procedures and the longer vacancy period. The persistently high level of the Ifo employment barometer could likewise be a result of difficulties in filling vacant positions. The more labour supply becomes the limiting factor for an increase in employment, the more a persistently high demand for labour amongst firms can be accompanied by a slowdown in employment growth. The slightly

downward trend is likely to continue for registered unemployment. The leading indicator for unemployment in the labour market barometer of the Institute for Employment Research (IAB) is still marginally in positive territory.

## Wages and prices

Reflecting the favourable economic situation and growing labour shortages, negotiated pay rates continued to rise at rates above the longer-term average in the reporting quarter. At 2.8%, the year-on-year increase in negotiated rates of basic pay in the third quarter of 2018 roughly matched the significant increase seen in the second quarter. While negotiated wages in the production sector including construction continued to increase substantially in the third quarter in comparison with the previous year, the year-on-year rates in the services sectors fell markedly. The low wage increases agreed at financial service providers, in the wholesale and retail trade and for the cleaning of buildings were key factors in this development. As fewer collectively agreed special payments were due than in the second quarter, in the economy as a whole the 2.8% year-on-year increase in negotiated wage rates including additional benefits was weaker in the third quarter of 2018 than in the second quarter (3.3%). Actual earnings are likely to have shown robust growth again in the third quarter.

*Strong underlying momentum in negotiated pay rates continues*

Following the conclusion of the latest pay agreement in the chemical industry, which will see wages climb sharply by around 3¾% in annualised terms, this year's pay round has all but come to an end. Pay agreements were characterised, in most instances, by markedly higher wage growth than in the past two years, and they were concluded for longer periods in many cases. Furthermore, it was often agreed that large hikes in negotiated rates of pay would occur at the start of the agreement period, followed by lower or no rises later on. In some industries, employees also had the op-

*2018 pay round with distinctly higher wage increases on the whole*

tion of choosing between wage increases or more leisure time in lieu thereof.

*Inflation rate up further in Q3 from elevated level*

Consumer prices (HICP) in the third quarter were again up markedly on the preceding three-month period, recording an increase of 0.5% in seasonally adjusted terms. Given the steady rise in crude oil prices up to then, energy prices went up by roughly as much as in the previous quarter. As a result of abnormal weather conditions, food prices likewise continued to climb, albeit at a slower pace than in the second quarter. In the case of clothing and footwear, though, which are likewise subject to fairly strong price fluctuations, there were exceptionally large discounts. Overall, however, non-energy industrial goods prices grew at a markedly faster pace than in previous quarters, in part because the euro has continued to depreciate against the US dollar. For instance, vehicle sales prices increased by 0.8%. The prices of services continued to rise moderately. The partial or full abolition of charges for day care facilities for small children in a number of federal states had a dampening effect here.<sup>3</sup> By contrast, significantly more had to be spent on other services. This was particularly the case for those services – cleaning being one such example – where wages represent a high share of costs. Compared with the previous year, annual headline HICP inflation increased from 1.9% to 2.1%.<sup>4</sup> Excluding energy and food, however, the rate decreased marginally from 1.2% to 1.1%. After factoring out the abolition of charges for day care facilities for small children and the volatile components of clothing and travel, it rose slightly.

*Rate significantly above 2% in October ...*

In October, consumer prices increased by a seasonally adjusted 0.2%. Energy prices went up again significantly as a result of crude oil prices continuing to rise up until the middle of the month. Prices for services were moderately higher across the board. By contrast, in the case of industrial goods excluding energy, the significant rate at which prices had previously risen slowed somewhat. Food prices remained unchanged on the whole. Annual headline

HICP inflation went up from 2.2% to 2.4%.<sup>5</sup> Excluding energy and food, the distinct rise in inflation from 1.2% to 1.5% was partly due to the fact that prices for motor vehicle insurance and travel services were cut substantially in October 2017.

In the coming months, the inflation rate is likely to be somewhat weaker due to the more subdued rise in energy and food prices. Excluding energy and food, the rate of 1½%, which is high in a longer-term comparison, could be maintained. For example, the import and industrial producer prices for industrial goods excluding energy are on a comparatively clear upward trajectory in terms of their trend. At the same time, higher crude oil prices could indirectly affect inflation excluding energy and food, for example in travel services.

*... but rates not expected to be quite as high in coming months*

## ■ Orders received and outlook

Having experienced a setback in the third quarter, the German economy is expected to see fairly strong growth again in the final quarter of 2018. Output and exports of motor vehicles are thus expected to return to normal before the year is out. The manufacturing sector as a whole likewise looks set to report marked growth. For instance, demand for imported intermediate goods was very buoyant in the past quarter. Although new orders have not yet been able to break the steady downward trend that took hold at the start of the year, industry order books remain well filled. In addition, Ifo Institute data indicate that short-term output expectations remain well above their long-term average. In addition, private consumption is expected to re-assume its role as a major economic driver. The still outstanding income and

*German economy back on expansionary course by end of year*

<sup>3</sup> This affected Lower Saxony, Hesse, Berlin and Brandenburg. With state-weighted fees accounting for 0.04% of HICP, this reduced the headline rate by around 0.05 percentage point.

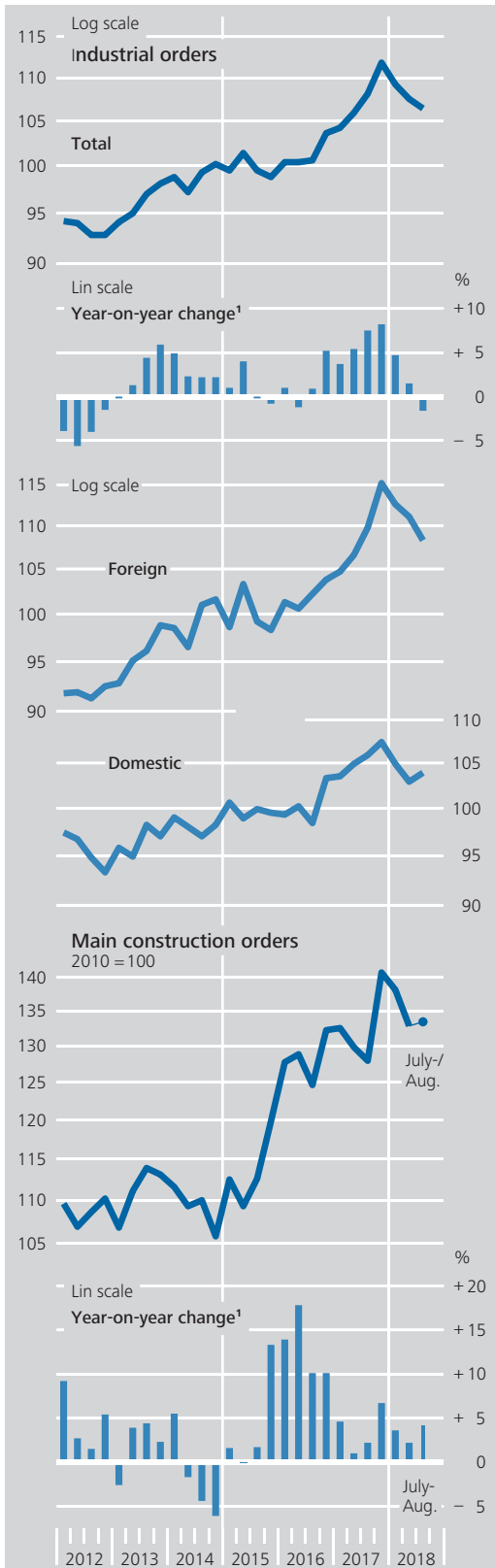
<sup>4</sup> The headline CPI figure was +2.1% compared with +2.0%.

<sup>5</sup> The CPI figure was 2.5% compared with 2.3%.



### Demand for industrial goods and construction work

Volume, 2015 = 100, seasonally adjusted, quarterly



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

labour market prospects are expected to again provide a boost.

Sentiment in the German economy deteriorated again somewhat of late, after brightening significantly during the third quarter. According to the Ifo Institute surveys, there was a particular deterioration in business expectations. Furthermore, sentiment suggests that mainly export-oriented firms are looking to the future with less confidence. The business climate index in manufacturing posted a particularly strong decline and thus continued the steady downward trend that took hold at the start of the year. Short-term export expectations were also less favourable here than in the third quarter. By contrast, there was only a slight deterioration in sentiment in the wholesale and retail trade and other services sectors. In the main construction sector, the business climate even posted a new record high, driven by a significantly improved assessment of the current situation. The most recent autumn survey by the German Chamber of Commerce and Industry (DIHK), which covers a longer time horizon of 12 months, indicates similar sentiment. Here again, the deterioration was mainly seen in the expectations of large enterprises in the industrial sector, which are, in general, particularly strongly integrated into global value chains. According to the DIHK, this is mainly due to concerns about global trade policy.

*Sentiment deteriorated again somewhat of late*

In the third quarter of 2018, new industrial orders fell significantly short of their level in the previous quarter. Nevertheless, the downward trend that took hold at the start of the year weakened somewhat. Broken down by region, negative impulses mainly emanated from flagging external demand. There was a stronger decrease in new orders from the euro area than from non-euro area countries. By contrast, enterprises received significantly more orders from customers in Germany, with large orders made on an irregular basis making up a particularly large portion of these. Excluding large orders, the volume of new domestic orders contracted, too. Despite the rather sub-

*Fewer new orders but orders situation still favourable*

dued inflow of new orders, German industrial firms are not, however, likely to suffer a lack of orders. This is indicated by firms' assessment of the stocks of orders that have still not been processed, which according to the Ifo Institute remain well above their long-term average. According to Federal Statistical Office data, the order backlog in September was also considerably higher than in the second quarter.

*Construction capacity utilisation remains high*

The buoyant construction activity in Germany is also likely to continue unabated in the final quarter of 2018, but activity in the sector is not expected to expand substantially. Demand for construction work remained very high. On an average of July and August – the most recent months for which statistics are available – the intake of orders in the main construction sector was up distinctly on the previous quarter. The number of building permits granted, which has been more or less stable at a high level for quite some time now, also indicates that the construction boom is showing no signs of slowing down. However, capacity constraints in construction are still preventing sustained strong output growth. According to the Ifo In-

stitute, equipment utilisation in the main construction sector is still very high, as is the share of construction firms reporting production hold-ups owing to the shortage of skilled workers.

Following the weak summer, private consumption is likely to grow again significantly in the final quarter of 2018. Primarily sales of textiles, clothing and footwear are expected to see a distinct countermovement, after turnover in these areas slumped during the summer on account of the weather. Furthermore, car sales are likely to pick up again following the turbulence in the previous quarter, even if consumers are still unsettled due to the continuing debate about a ban on motor vehicles with high emissions levels. Underlying conditions for consumption remain excellent overall. Employees are benefiting from significant wage increases while the unemployment rate is marking fresh lows. This is reflected in consumer sentiment. The consumer climate index compiled by the market research institution Gesellschaft für Konsumforschung (GfK) remains at an exceptionally high level.

*Private consumption to recover at end of year*