Global and European setting

Global economic developments

Global economic growth somewhat slower

In the second quarter of 2019, the global economy probably expanded at a somewhat slower pace than in the preceding quarter. The upturn decelerated distinctly in the advanced economies, in particular. A key reason was that one-off factors that had previously been supporting growth were no longer present. After a strong start to the year, the euro area economy returned to the flat growth path it had been charting previously. Economic growth also slowed in the United States and Japan, although final domestic demand gained significant momentum. In the United Kingdom, real gross domestic product (GDP) even contracted. The Chinese economy's growth rate, which is high by international standards, recorded a slight year-on-year decrease. In other large emerging market economies, economic activity remained subdued, after slowing down considerably at the beginning of the year.

IMF revises projections down slightly; outlook for global trade significantly more pessimistic

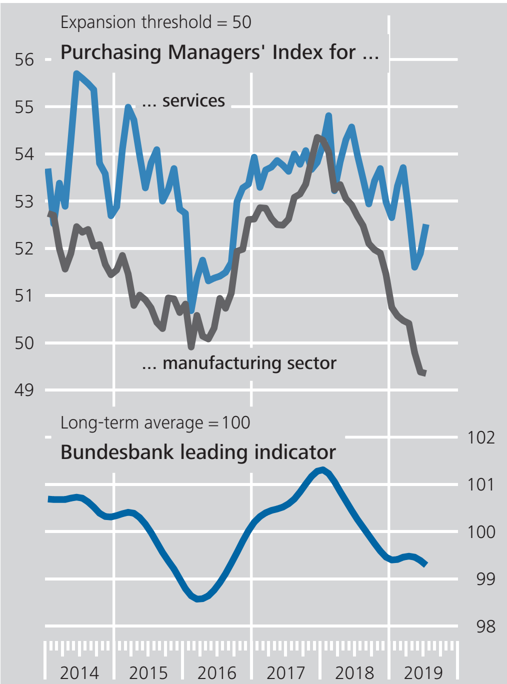
On account of the weak start to the year in some emerging market economies and as a result of the further intensified trade dispute between the United States and China,[1] the staff of the International Monetary Fund (IMF) lowered their projections in July for the group of emerging economies markedly for the current year and marginally for the following year.[2] These adjustments were also reflected in the slight downward revisions of global GDP growth in both years. By contrast, IMF staff were considerably more pessimistic about the dynamics of global trade, especially in the current year.

Global trade still anaemic

Growth in global trade has in fact been fairly weak for some time now. According to data from the Dutch Centraal Planbureau, the average monthly volume of international goods trade for April/May remained, after seasonal adjustment, ½% below the level of the first quarter. There had already been declines in the fourth quarter of 2018 and the first quarter of 2019. One reason that is frequently cited for the persistent weakness in global trade is the trade dispute between the United States and China. Bilateral trade flows indeed decreased considerably. Perhaps more significant, however, were flagging industrial activity and investment even in countries not directly affected by the trade dispute. Overall, global industrial output on an average of April and May grew only slightly again compared with the level of the first quarter.

Indicators for the global economy

Index points, seasonally adjusted, monthly data



Sources: IHS Markit, J.P. Morgan and Bundesbank calculations based on data produced by IHS Markit, J.P. Morgan and sentix GmbH, as well as Standard and Poor's, which are provided by IHS Markit.

Deutsche Bundesbank

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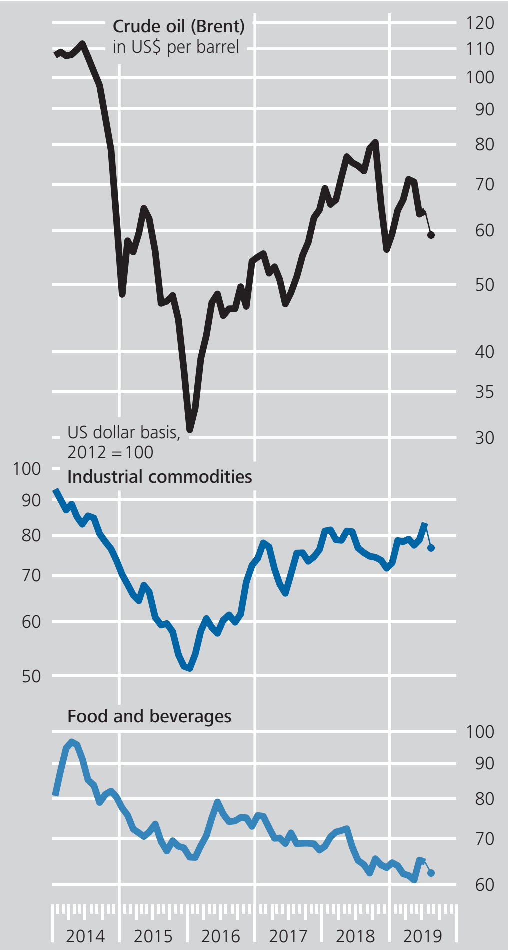
1 The projections already take account of the increase in punitive tariffs on US goods imports from China which took effect in May 2019 (and the Chinese retaliatory measures), but not the additional tariffs recently announced by the United States, scheduled to take effect in two batches in September and December 2019.
2 See International Monetary Fund (2019).

World market prices for crude oil, industrial commodities and food and beverages

Monthly averages, log scale



Sources: Bloomberg Finance L.P. and HWWI. • Latest figures: average of 1 to 9 August 2019, or 1 to 15 August 2019 for crude oil.
Deutsche Bundesbank

Sentiment in the manufacturing sector gloomy; in the services sector, by contrast, robust

The leading indicators do not yet appear to point to a substantial strengthening of global trade. In July, the Purchasing Managers' Index for the global manufacturing sector remained entrenched below the expansion threshold. The assessment for export orders remained particularly pessimistic. Of all industries of the manufacturing sector, foreign demand flagged especially in the automotive industry.[3] The Bundesbank leading indicator for the global economy has been pointing to listless industrial activity for quite some time now.[4] Despite the persistent slowdown in industry, survey results show that business activity in the services sector has remained relatively robust. This is likely to support employment growth and hence private consumption, as a key pillar of economic activity. For the pace of global growth to pick up, however, industrial activity will need to recover.

Crude oil price trending downwards

With the escalation of the trade dispute between the United States and China, concerns about a weakening of the global demand for oil increasingly emerged in the second half of May. Against this backdrop, crude oil prices fell considerably. Supply-side factors, such as political tensions in the Middle East or weather-related production stoppages in the United States, temporarily contributed to a stabilisation of prices. Following the announcement of new import duties by the United States in early August, there was a further marked fall in prices. As this report went to press, the spot price for a barrel of Brent was around US$58, after having traded for just under US$71 as late as May. This pushed the price of crude oil down by around 17% on the year. According to the International Energy Agency's forecasts, the world oil market is likely to be balanced for the remainder of the year.[5] The extension to existing production cutbacks recently agreed by OPEC and its partners is likely to play a key role in this.

Other commodity prices rather volatile

In contrast to crude oil prices, prices for industrial commodities and food increased, in some cases markedly, between May and July. This was driven largely by shortages on the supply side, with Australia and Brazil continuing to experience production losses in iron ore. The harvest outlook for cereals as well as luxury and semi-luxury food and beverages also deterior-

3 For a discussion of the current weakness of global demand for passenger cars and its outlook, see Deutsche Bundesbank (2019a).
4 The Bundesbank leading indicator, developed in order to identify cyclical turning points in global industrial activity, is based on a principal component analysis of global economic parameters. The Bundesbank leading indicator's time series is available at: https://www.bundesbank.de/dynamic/action/en/statistics/time-series-databases/time-series-databases/759784/759784?listId=www_s3wa_inet_bbli
5 See International Energy Agency (2019).

ated in some regions. In August, however, prices fell across the board. Accordingly, the HWWI index for non-energy commodities was virtually unchanged from three months earlier.

Moderate increase in consumer prices in industrial countries

In line with the significantly reduced crude oil prices, inflation also declined somewhat in industrial countries. Annual consumer price inflation dropped from 1.8% in April to 1.5% in June, while core inflation, which strips out energy and food prices, remained at 1.7%. The underlying inflationary pressures thus remained moderate.

Selected emerging market economies

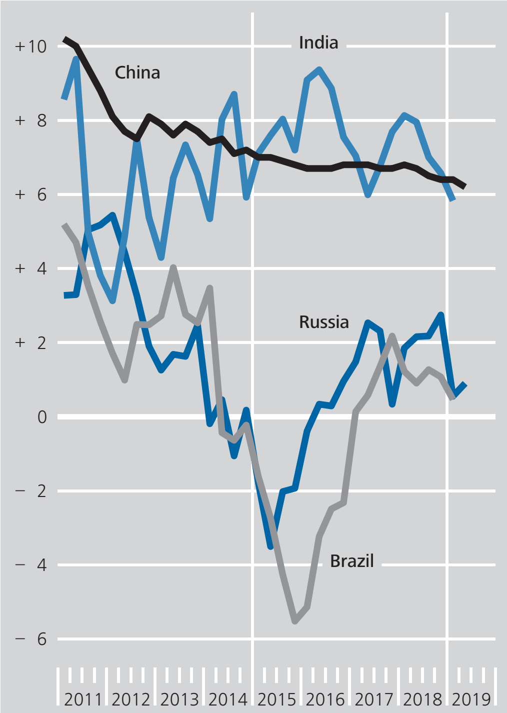
Slight decline in economic growth again in China

According to official data, annual real GDP growth in China in the second quarter decelerated to 6.2%. The gradual slowdown in growth which began in the second quarter of 2018 has thus continued. Perceptible economic headwinds for the Chinese economy continued to come from the international environment. In the past quarter, revenue from the export of goods in US dollar terms were down by 1% on the year. This was not just attributable to a sharp decline in exports to the United States as a result of the trade dispute. Exports to other economies, too, continued to lose steam owing to the subdued global economy. While the slowdown in the export business weighed significantly on business investment, the upturn in private consumption appears to have been robust. High wage increases and a stable situation on the labour market are likely to have played a major role in this development. In addition, income tax was lowered at the end of 2018. However, distinctly higher food prices eroded some of households' purchasing power.[6] This is the main reason why the rate of inflation as measured by the consumer price index (CPI) rose from 1.8% in the first quarter to 2.6% in the second quarter.

In India, economic activity in the second quarter, for which there is not yet an official GDP

Economic growth in selected emerging market economies

Year-on-year percentage change in real GDP



Source: IHS Markit.
Deutsche Bundesbank

estimate, is not likely to have improved substantially. In the first quarter of 2019, real annual GDP growth declined rather significantly to 5.8%. One major reason for the slowdown in growth seems to have been problems in the shadow banking sector, which, in India, plays a key role in the supply of credit to households and small enterprises. Many of these financial service providers have encountered refinancing difficulties, leading them to cut back their lending. Consumer price inflation remained moderate by Indian standards in recent months, at around 3%. Against that backdrop, the central bank maintained the loose monetary policy stance it had adopted at the beginning of the year.

Economic activity in India still listless

In Brazil, economic output in the second quarter after seasonal adjustment is likely to have

6 This was primarily due to the sharp increase in pork prices as a result of African swine fever, which has already cost China one-quarter of its herd. China is therefore currently buying pork around the world on a large scale.

At most, slight economic growth in Brazil

increased marginally at best compared with the preceding quarter, in which it had contracted by 0.2%. This decline was largely attributable to production stoppages in the mining sector as a result of a dam burst. These losses were not yet able to be recouped in the reporting period. Furthermore, economic activity in other economic sectors, such as in the manufacturing sector, remained very quiet. Consumer price inflation in the second quarter remained at just over 4% on the year, and was thus in line with the central bank's inflation target. Given the lower inflation expectations, the central bank cut its policy rate by 50 basis points at the end of July to a new all-time low of 6%.

Russian economic activity remains subdued

In Russia, the pace of economic growth has likewise remained subdued. According to the first estimate released by the Russian Federal State Statistics Service, real GDP in the second quarter rose by 0.9% on the year. The main reason for the persistent economic weakness was muted domestic demand, as private consumption appears to have once again increased only moderately – not least because of the increase in VAT at the beginning of the year. The development of business investment was probably still sluggish, too. The receding export revenues as a result of the distinct fall in oil prices compared with the previous year, as well as the production cutbacks agreed with OPEC, are likely to have played a role here. Consumer price inflation waned slightly in the second quarter, to 5.0%. Also owing to the gloomy economic outlook, the Russian central bank reduced its policy rate in June and July, each month by 25 basis points, to 7.25%.

United States

Marked slowdown in growth despite stronger final demand

According to the first official estimate, seasonally adjusted real GDP in the United States increased in the second quarter by 0.5% compared with the first quarter. Therefore, as expected, the fast pace recorded at the start of the year could not be maintained. The moderation of growth was largely down to US enterprises restocking more slowly, along with a setback in foreign business. In line with the weakness in world trade, US exports were significantly lower again after the marked increase in the first quarter, with imports virtually unchanged. Finally, business investment also stalled, with declines in the aviation and mining industries contributing to this. By contrast, economic activity was temporarily supported by a robust expansion in public demand.[7] However, the material increase in households' consumption, after two quarters with rather subdued growth rates, had an even greater impact. Looking ahead, too, the underlying conditions for private consumption appear to remain favourable. A distinct pick-up in the saving ratio during the past one and a half years signals that households have not yet fully exhausted their scope for expenditure, which has also been increased through the tax reform.[8] In July, there was also once again marked growth in employment, and the unemployment rate remained close to its 50-year low. In line with the high utilisation of the labour market, wage growth also picked up again. Annual CPI inflation excluding energy and food also went up slightly to 2.2% in the same month. Despite the sound economic conditions, the US central bank cut its policy rate, pointing to elevated downside risks to the economic outlook, by 25 basis points at the end of July.

Japan

Economic activity remains quite buoyant

In Japan, the economy remained on a path of growth in the second quarter. According to the first official estimate, seasonally adjusted real

7 One reason for this sharp increase was further substantial growth in local investment expenditure on road construction, which had, however, already been reduced again significantly in the latter months of the second quarter. In addition, public consumption normalised following the end of the government shutdown, which had slowed the expansion of the US economy slightly in the fourth quarter of 2018 and the first quarter of 2019. See Deutsche Bundesbank (2019b).

8 In the most recent annual revision of the national accounts, the household saving ratio was upped markedly at the current end. At just over 8%, it now distinctly exceeds the 7% mark, around which it had fluctuated in 2017.

GDP rose by 0.4% on the quarter, following a buoyant increase of 0.7% in the first quarter. The expansion of domestic demand even accelerated distinctly, largely on account of a major expansion in private consumption. Business investment was also clearly up, while private housing construction lost some of its momentum. In line with the recovery in domestic demand, imports went up following the slump in the preceding quarter. By contrast, exports stagnated. The labour market situation remained very favourable. The already extremely low unemployment rate fell slightly further in June. Despite the tight labour market, wage growth remained sluggish. Consumer price inflation remained correspondingly subdued. In June, annual CPI inflation excluding energy and food was 0.3%. Against this backdrop, the Japanese central bank maintained its accommodative stance.

United Kingdom

Slight decline in GDP after lively first quarter

Economic output in the United Kingdom was unable to maintain the level of the previous quarter. According to an initial estimate and after elimination of the usual seasonal influences, real GDP fell by 0.2% compared with the previous period. This decline was chiefly caused by a significantly lower level of output in manufacturing, which had still benefited in the first quarter from stronger inventory production in anticipation of the United Kingdom's exit from the EU, which had originally been scheduled for the end of March. Many large car manufacturers also brought forward their plant shutdowns from the summer to the April as a precaution. This pushed motor vehicle production in the second quarter well below the level of the preceding quarter. Even the particularly economically important services sector, which has recorded falling growth rates since the end of 2018, no longer provided any distinct growth stimulus. By contrast, the labour market situation remained exceptionally favourable. At 3.9% after seasonal adjustment, the unemployment rate remained virtually unchanged on the quarter. Annual Harmonised Index of Consumer Prices (HICP) inflation rose slightly in the second quarter, to 2%.

Poland

Slowdown in economic growth; significant rise in consumer prices

In Poland, economic growth decelerated somewhat in the second quarter after a strong start to the year. The economy grew by 0.8% on the quarter after seasonal adjustment, following 1.4% in the preceding period. The year-on-year figure of 4.1% remained far above the EU average of 1.3%, continuing on the path of increased convergence of the past few years (see the box on pp. 16 ff.). One of the main reasons for the more moderate growth was the decline in construction output after a brisk first quarter. Another factor was the stagnation in industrial production. On the expenditure side, growth was borne up by private consumption thanks to the persistently favourable labour market situation. The second-quarter unemployment rate (3.8% after seasonal adjustment) remained close to its all-time low level. Annual Consumer Price Index (CPI) inflation surged to 2.4% in the second quarter. Core inflation excluding energy and food also rose considerably to 1.8%. Despite accelerating inflation, the Polish central bank left its policy rate unchanged.

Macroeconomic trends in the euro area

Only sluggish economic growth

The euro area economy grew only slightly in the second quarter of 2019. According to Eurostat's flash estimate, real GDP rose by a seasonally adjusted 0.2% from the preceding quarter, which had benefited from one-off factors.[9] Year-on-year growth fell to 1.1% and consequently remained slightly below the estimated growth rate of potential output. Thus the underlying upward trend, which has remained muted since the middle of last year, continued. It is being dampened by weak industrial activity

9 See Deutsche Bundesbank (2019c).

Progress in the convergence process of the central and eastern European EU Member States

Despite weaker global economic activity, growth in the central and eastern European EU Member States[1] remained lively throughout the reporting period. The real gross domestic product (GDP) of this group of countries rose in 2018 by 4.3% following growth of 4.8% a year earlier. The slight slowdown in economic activity was attributable mainly to exports, which distinctly lost steam owing to a more difficult external environment. The relatively fast pace of aggregate growth has been maintained in the current year to date, too. This may rest on two factors: robust domestic demand and considerable foreign direct investment (FDI), which, for instance, was associated with capacity extensions on the part of the German automotive industry, amongst other things.

Riding the wave of substantial economic growth, the region's labour markets continued to improve. The unemployment rate in many places hit very low levels last year, such as 2.2% in the Czech Republic and 3.9% in Poland. Collectively for the entire group of countries, it shrank to 4.3%. Wage growth, measured in terms of gross wages and salaries per employed person, consequently accelerated to 8.2% in 2018.[2] It thus considerably outpaced productivity growth, which averaged 3.3%.[3]

Consumer prices, too, picked up recently, especially in the non-euro area central and eastern European EU Member States. In this group of countries, the Harmonised Index of Consumer Prices (HICP) inflation rate accelerated to an average of 2.8% in the second quarter of 2019. Nonetheless, inflation rates remained within the national central banks' target corridors, with the exception of Romania.[4] In those countries that have already introduced the euro, inflation rose very little, averaging 2.6% over the same period.

Surging economic growth in the central and eastern European EU Member States distinctly reduced the income disparity between this group and the EU average. Measured in terms of per capita GDP, in 2018 this group of countries attained 46% of the EU average, compared to 41% in 2013. In terms of purchasing power standards, per capita GDP climbed to 72% of the EU average, up from 67% five years earlier.

These averages, however, mask considerable differences within the observed group of countries. Whereas the Czech Republic and Slovenia, measured in terms of purchasing power standards, are now at 90% of the EU mean per capita GDP, and Estonia, Lithuania and Slovakia are at around 80%, Poland, Hungary and Latvia are at around 70%. Croatia and Romania are at just over 60%, Bulgaria 50%. Measured in terms of per capita GDP in purchasing power standards, Romania, followed by

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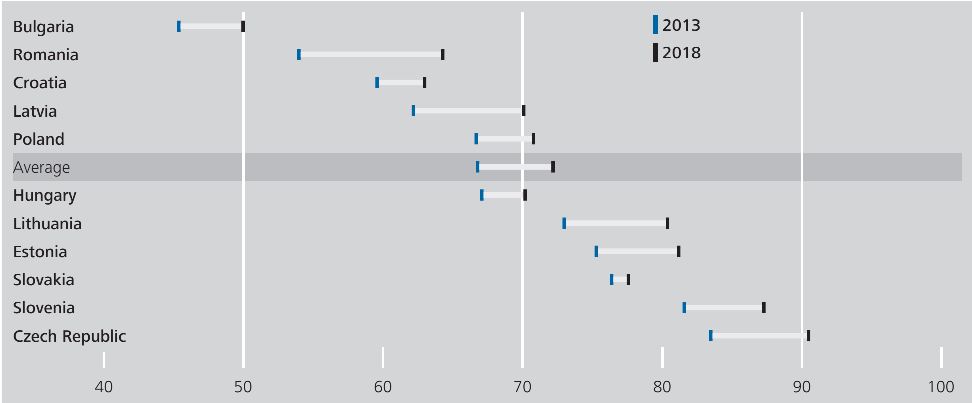
1 This group of countries comprises five EU Member States that belong to the euro area (Slovenia, Slovakia, Estonia, Latvia and Lithuania) and six other EU Member States (Poland, Czech Republic, Hungary, Romania, Bulgaria and Croatia).
2 The rate of average wage growth is calculated by weighting gross wages and salaries per employee (in local currency) with the relevant employment shares. Romania was factored out of this calculation because, at the beginning of 2018, social security contributions payable by employers were transferred to the charge of employees, which contributed in major ways to the annual wage growth of 35%. See National Bank of Romania (2018).
3 Average productivity growth is calculated by weighting the growth rates of real GDP per employed person in the countries in question with the relevant employment shares.
4 Based on national consumer price indices, the rates of change of which can vary slightly from HICP inflation rates.

Per capita GDP in central and eastern European EU Member States

As a percentage of mean per capita GDP in the EU, purchasing power adjusted



Sources: Eurostat and Bundesbank calculations.
Deutsche Bundesbank

Latvia and Lithuania, showed the greatest progress over the past five years. The gains made over the same period by Slovakia, Hungary and Croatia, but also Poland, were less pronounced. However, the convergence progress, measured in terms of this criterion, did not go into reverse in any of the countries under review.

To date, the convergence progress attained over the past few years has not been associated with any broad-based acceleration of macroeconomic imbalances. Public debt to GDP ratios fell in all countries under review. Almost all countries also saw a drop in their respective net external debt to GDP ratio. Either current account surpluses were achieved or current account deficits remained, in the vast majority of cases, within tight constraints.[5]

However, there have recently been signs of a cyclical overheating of labour markets. Since wage growth has considerably outpaced productivity gains in all countries under review at the current end, unit labour costs have risen sharply and competitiveness declined. Under the EU procedure on the prevention and correction of macroeconomic imbalances, a rise in unit labour costs of at least 9% (euro area Member States) or 12% (non-euro area EU Member States) over a three-year period is assessed as a sign of potential imbalances. This was noted last year for seven of the countries under review.

One of the key factors in the progress made by the central and eastern European countries in convergence is likely to be their increasing integration into the single European market and the global economy. The average external openness of this group of countries has gone up over the past five years from 59% to 64%.[6] This growing openness has been fostered by, amongst other factors, infrastructure modernisation, not least with the help of the EU structural and cohesion fund. The stability of the underlying framework conditions associated with EU membership has also encouraged extensive foreign direct investment

5 However, these three countries did manage to breach the "indicative thresholds" of the European Commission's macroeconomic imbalance procedure for the public debt criterion. Seven countries breached it in respect of net external debt and three countries in respect of house price increases.
6 Calculated as half the sum of exports and imports of goods and services (as defined in the national accounts) as a percentage of GDP.

(FDI) and integration into cross-border value-added chains.[7]

Future progress in convergence will also hinge on the success of efforts to further enhance the quality of institutions. According to the Worldwide Governance Indicators published by the World Bank,[8] the Czech Republic was the only central and eastern European country to outperform the EU average in 2017. Other countries lagged behind, in some cases by a considerable margin, particularly in the areas of regulatory quality, rule of law and control of corruption. The World Bank's surveys even identified back-tracking in some areas. According to the Global Competitiveness Report for 2018 prepared by the World Economic Forum (WEF), although most central and eastern European EU Member States' locational conditions improved slightly, none of these countries has caught up to the EU average thus far.[9]

An improvement in the quality of institutions is probably also a prerequisite for increased investment in research and development (R&D) in those countries. According to Eurostat, R&D spending in central and eastern European countries in 2017, at an average of 1.2% of GDP, lagged considerably behind the EU average of 2.0%. Although technological progress can be imported, for instance through FDI, an increase in R&D activity is likely, in most cases, to be associated with above-average increases in value added.

In the past few years, the central and eastern European EU Member States have continued to catch up to the rest of the EU in terms of economic performance. The benefits of this progress have also been accruing to workers on a greater scale thanks to the strong wage growth over the past few years. Individual countries, especially those in close geographical proximity to the economic centres of western Europe, are already approaching the EU average. Owing to robust domestic demand and extensive FDI, the deceleration of global trade has had little impact on these countries' economic development thus far. Further substantial convergence progress is likely to hinge on maintaining competitiveness and enhancing the quality of institutions.

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7 See European Central Bank (2018).
8 The World Bank's "Worldwide Governance Indicators" contain six individual indicators (Voice and Accountability, Political Stability and Absence of Violence, Government Effectiveness, Regulatory Quality, Rule of Law, and Control of Corruption), from which a simple average was computed. The country aggregates were calculated via population shares. See also World Bank (2019), https://info.worldbank.org/governance/wgi/#doc
9 The WEF's Global Competitiveness Index 4.0 assesses locational conditions on the basis of institutions, policy measures and other factors that can impact on productivity. Cross-country averages were calculated based on population shares. For more information, see World Economic Forum (2018).

largely caused by external factors. By contrast, the more domestically oriented sectors, supported by marked gains in household incomes and favourable financing terms, continued to see growth. These driving forces will probably bolster economic activity in the months to come as well. Though the sentiment indicators for the services and construction sectors fell recently in some cases, they are nevertheless still pointing to expansion.

Robust upward movement in private consumption

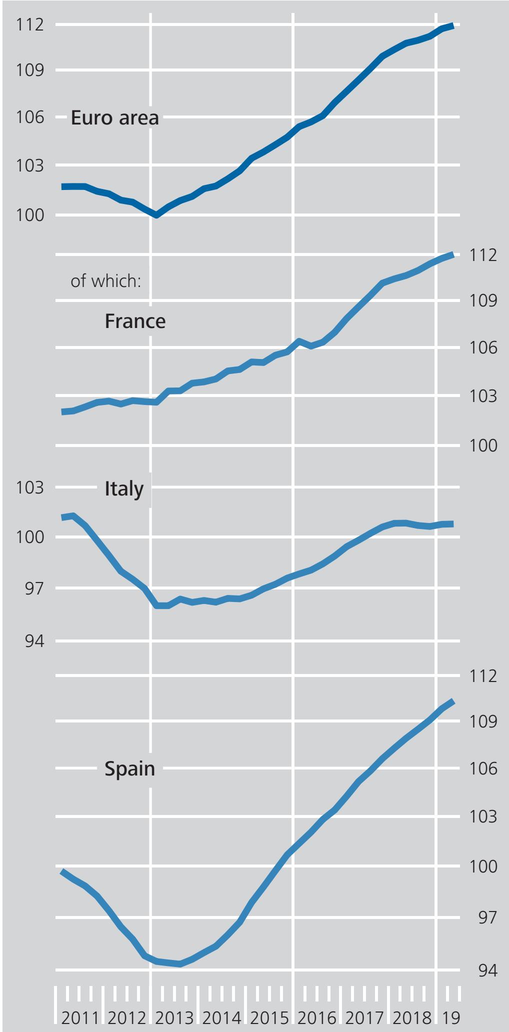
Private consumption in the euro area is likely to have lost some steam in the second quarter following a strong start to the year. Retail sales, after price and seasonal adjustment, were up less strongly than in the first quarter, while the rise in new motor vehicle registrations also levelled out. However, it should be borne in mind that car purchases were made at the start of the year which had probably been postponed due to supply difficulties. In general, private consumption remained resilient.

Marginal growth in investment

Gross fixed capital formation was likely up only slightly in the second quarter. This growth, marginal at best, follows on from an already weak start to the year. This was largely due to the collapse in investment spending in Ireland, however. By contrast, in the rest of the euro area gross fixed capital formation increased considerably at the beginning of the year. The extremely favourable weather conditions in several Member States had also played a role in this regard, giving construction activity an additional boost. In the second quarter, after seasonal adjustment, this high level of construction activity is unlikely to have been maintained. In any case, construction output fell on an average of April and May. Investment in machinery and equipment appears to have risen only marginally in the second quarter. This is likely to have been slowed by sluggish industrial activity. In any event, the domestic sales achieved by capital goods producers on average in April and May remained virtually unchanged.

Aggregate output in the euro area

Real GDP, 2010 = 100, seasonally adjusted, quarterly data, log scale



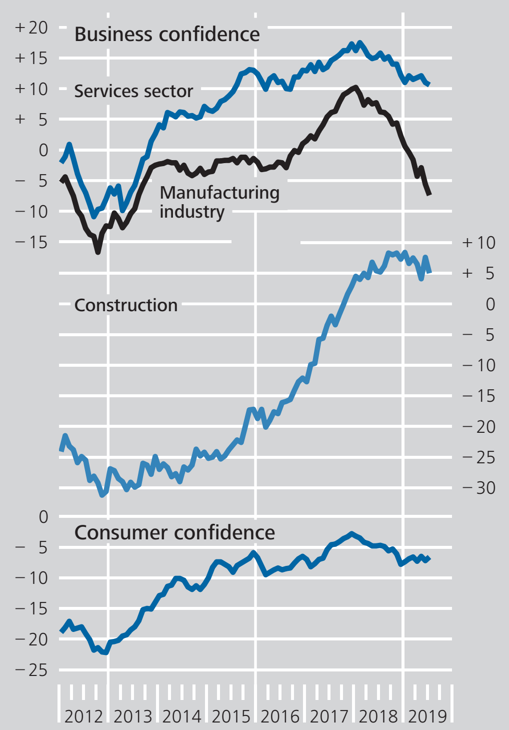
Source: Eurostat.
Deutsche Bundesbank

Exports to third countries down in value

The value of exports to non-euro area countries decreased markedly in the second quarter according to the foreign trade statistics. This was primarily due to a drop in exports to the United Kingdom, where inventories had been built up prior to the original date planned for its departure from the EU at the end of March. In addition, exports to Turkey fell once more. Likewise, deliveries to China decreased following significant growth, whereas exports to the United States were up distinctly once again. As a result of the recent rebound in export prices, the volume of exports to third countries is likely to have gone down considerably. The same is

Sentiment indicators for the euro area

Percentage balances of positive and negative responses, seasonally adjusted, monthly data



Source: European Commission.
Deutsche Bundesbank

probably also true of imports. By comparison, intra-euro area trade remained more positive.

Industrial production down; services continue upward trajectory

Industrial production fell markedly in the second quarter. The production of intermediate goods declined distinctly, while that of capital goods contracted significantly. Once again, considerably fewer cars rolled off the assembly lines. Consistent with the robust level of private consumption, the production of consumer goods increased further by contrast. Output in the services sectors was up again markedly in April and May.[10] As in the preceding quarters, the provision of services in freelance and scientific activities saw especially strong expansion.

Slowdown widespread across Member States

In most euro area countries, for which GDP data are already available, aggregate growth slowed down in the second quarter. In France, quarterly real GDP growth fell slightly to 0.2%. Although the increase in private consumption decreased somewhat, the rise in investment activity firmed markedly. However, this was offset by a negative contribution to growth from changes to inventories. Exports were up only slightly, as in the previous quarter. Likewise, imports rose only marginally after a significant increase at the start of the year. Economic activity stagnated in Italy after minimal growth at the beginning of 2019. Exports in particular are likely to have bolstered economic activity once again. In any event, Italian goods exports increased distinctly in the second quarter according to the foreign trade statistics, especially in trade with partner countries in the euro area. By contrast, no growth stimulus came from the domestic economy. Private consumption is likely to have risen only slightly, and investment was probably unable to maintain the elevated level of the first quarter, in which construction activity had benefited from favourable weather conditions. The Spanish economy continued to see the strongest expansion among the large Member States, even though GDP growth waned from 0.7% to 0.5%. Investment in machinery and equipment subsided significantly after a substantial increase in the preceding quarter. On the other hand, construction investment continued to grow. Private consumption once again expanded only moderately. Exports and imports strengthened substantially after a sluggish start to the year. GDP growth rates also declined in Austria and Belgium, while they remained unchanged in the Netherlands and Portugal. Economic activity remained persistently lively in some eastern Member States in particular.

Further improvement in labour market situation

The euro area's labour market situation continued to brighten in the second quarter. The number of unemployed people fell by 235,000 compared to the first quarter, after seasonal adjustment, and by 1.1 million on the year. Consequently, the standardised unemployment rate fell to 7.5% by June and thus was only

10 An index for services production in the euro area has been published by Eurostat since the start of the year. Due to a rather limited dataset, the indicator has so far been classed as experimental. See https://ec.europa.eu/eurostat/statistics-explained/index.php/Services_production_(volume)_index_overview

0.2 percentage point above the cyclical low prior to the onset of the global financial and economic crisis. According to Eurostat's flash estimate, the number of persons in employment rose in the second quarter by a seasonally adjusted 0.2%. The brisk pace of the preceding quarter therefore could not be maintained. Survey results show that labour shortages in manufacturing continued to ease in July, while they resurged in the services sector. Wage growth, as measured by the year-on-year rate, is expected to have remained moderate.

Sharp increase in consumer prices due to energy and services

In the second quarter of 2019, consumer prices in the euro area were up substantially by 0.5% on the quarter after seasonal adjustment, after having stagnated in the first quarter. This was predominantly due to energy prices which, on average in the first quarter, had fallen temporarily in line with crude oil prices before then bouncing back in the second quarter. Consumers also had to pay considerably more for services in the second quarter, and the late date of the Easter holidays played a role in this regard. Furthermore, food prices saw a steep rise, while the prices of non-energy industrial goods remained largely unchanged. Annual headline HICP inflation persisted at 1.4% as energy and food prices had also increased sharply in the second quarter of 2018.

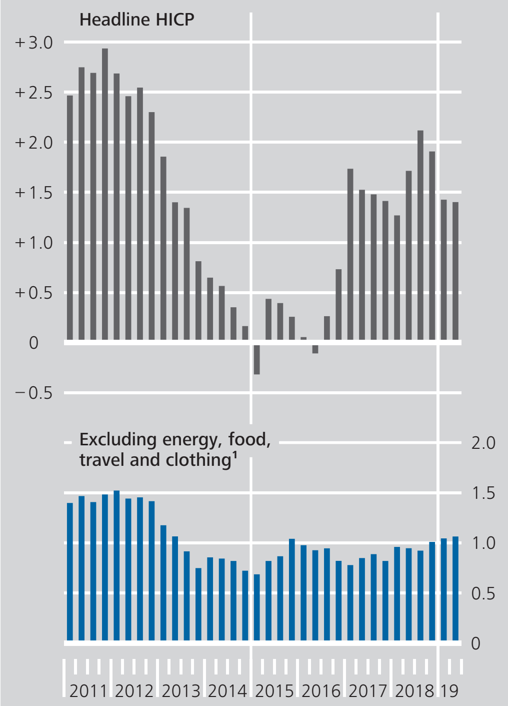
Underlying inflation somewhat stronger

Inflation excluding energy and food rose slightly to 1.1%. If the sub-indices for clothing and travel, which have been more highly volatile since the liberalisation of seasonal sales activities and changes to statistical reporting and therefore frequently obscure the underlying price trend, are stripped out,[11] there has been a slight but relatively constant increase in core inflation thus defined from 0.8% to 1.1%. This upward trajectory can be seen not only across the euro area as a whole but also in all Member States apart from Belgium and Italy. The rates range from 0.2% in Greece to 1.5% in Germany to 2.6% in Latvia.

In July 2019, seasonally adjusted consumer prices rose slightly by 0.1% according to Eurostat's flash estimate. Food and industrial goods excluding energy, in particular, became markedly more expensive, while energy prices eased slightly and the prices for services remained largely unchanged. As a result, annual HICP inflation declined to 1.1% and the rate excluding energy and food fell to 0.9%. However, this decrease is probably mainly due to a one-off effect in connection with the statistical treatment of prices for package holidays in Germany (see the box on pp. 57 ff.).

Underlying inflation in the euro area

Year-on-year percentage change



Sources: Eurostat and ECB. **1** Clothing also includes footwear (COICOP 03); travel includes package holidays (096), accommodation services (112) and passenger transport by air (0733).
Deutsche Bundesbank

Annual HICP inflation in July muted by arithmetical effects

Growth acceleration unlikely in Q3

For the third quarter, there are signs that the euro area will continue its path of muted economic growth. There is no end in sight yet to industry's slump. Both the Purchasing Managers' Index for manufacturing and the European Commission's corresponding sentiment indicator declined once again in July. Both remained either within contractionary territory or

11 See Deutsche Bundesbank (2017) and Deutsche Bundesbank (2019d).

below the long-term average. Capacity utilisation in manufacturing exceeded its longer-term average only slightly following a further decline, while incoming orders continued their downward trend. More promising signals came from domestically oriented sectors, which are benefiting from the positive labour market situation and the favourable financing conditions. The sentiment indicators published by the European Commission for the construction sector and consumers remained at a high level throughout the reporting period, and the indicator for the services sectors has remained above its long-term average. It should also be noted that the importance of manufacturing is lower for the euro area as a whole as well as for most euro area countries than it is for Germany, and aggregate growth in the euro area is consequently less strongly affected by industry than it is here. Given that the drivers of the domestic economy are largely intact, GDP is likely to pick up in the third quarter as well. That said, sentiment in the construction and services sectors has also become somewhat gloomier recently, indicating the danger that a protracted stretch of sluggishness in manufacturing could spill over to other sectors of the economy.

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