

Economic conditions in Germany

Macroeconomic situation

German economy down slightly in second quarter of 2019

Economic output in Germany contracted slightly in the second quarter of 2019. According to the Federal Statistical Office's flash estimate, real gross domestic product (GDP) decreased by 0.1% on the previous quarter after seasonal and calendar adjustment.¹ It was 0.4% up on the year in calendar-adjusted terms. Thus, the underlying trend of economic growth was still slightly positive overall in the past four quarters, but significantly lower than the increase in potential output. A number of factors played a role in the second-quarter decline in GDP. First, the downturn in industry intensified slightly on the back of decreased foreign demand. A contributing factor was that the date of Brexit in the United Kingdom, initially scheduled for the end of March, led to substantial stockpiling in the first quarter. Exports to the United Kingdom were therefore especially weak in the second quarter. Second, one-off effects that had supported economic activity in the first quarter put a distinct brake on the generally still intact domestic expansionary forces. For instance, construction output dropped off steeply after expanding strongly in the first quarter due to favourable weather conditions. Meanwhile, demand for cars, pent up by delivery bottlenecks last year, was largely met in the first quarter and did not increase further in the reporting quarter. This curbed private consumption. Economic activity could decline again slightly in the current quarter. There are no signs yet of an end to the downturn in industry. This could also gradually start to weigh on a number of services sectors.

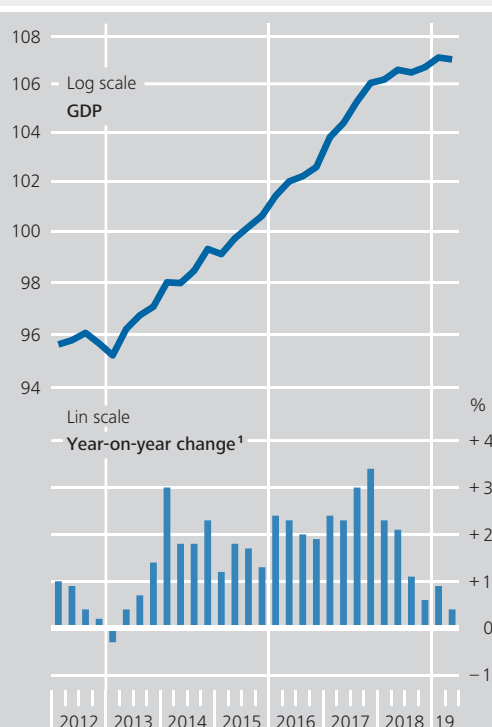
¹ The overall economic picture for the previous years remained broadly unchanged following the major revision of the national accounts conducted at the same time. The GDP growth in the already strong year of 2017 was revised upwards by 0.3 percentage point to 2.8% in calendar-adjusted terms. Furthermore, the underlying cyclical trend was somewhat more subdued in the first half of 2018, but was stronger in the second half of the year.

The slight decline in economic output in the second quarter was quite broadly spread across sectors. Only retail trade and some other services sectors are likely to have provided positive momentum. By contrast, sales in the construction sector and in the hotel and restaurant sector declined. Wholesale trade slid into the downturn afflicting industry. On the demand side, too, economic activity saw a broad-based weakening. Private consumption is likely to have only slightly exceeded the level of the strong preceding quarter. Exports were down substantially. Against this backdrop, and in the light of declining capacity utilisation and the subdued outlook for manufacturing, businesses probably held back on investing in new machinery and equipment. Construction investment also went into reverse. Government consumption may have provided the only meaningful boost to economic activity. Aggregate

Economic activity weak across the board

Overall output

2015 = 100, price and seasonally adjusted



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



capacity utilisation is still above average, despite the decline in the past few quarters.

Substantial decline in exports

In price-adjusted terms, German exports of goods declined substantially in the second quarter of 2019. The flow of goods to the euro area in value terms, as well as to third countries outside the euro area, contracted considerably. However, the decline in non-euro area countries was due mainly to the sharp decline in exports to the United Kingdom. A significant number of purchases were brought forward in the run-up to the original Brexit date at the end of March, which were missing in the reporting period. According to seasonally-adjusted Fed-

eral Statistical Office data available up to May, demand from the United Kingdom for German intermediate and consumer goods suffered particularly as a result of this rebound effect. By contrast, the exports of goods to other non-euro area countries decreased only marginally on balance. Exports to the new industrial countries in Asia, as well as to Japan, fell considerably. There was also a substantial decline in business with China. Conversely, deliveries to the United States and to South Asian and South East Asian emerging economies were sources of impetus. German exporters also enjoyed a steep rise in demand from Russia. Exports to central and eastern European countries remained at the level of the previous quarter. Broken down by category of goods, there was a particularly strong decline in exports in intermediate goods, followed by capital goods, in terms of value. By contrast, consumer goods exports saw a considerable increase.

Commercial investment is estimated to have weakened distinctly in the second quarter of 2019 against the backdrop of the ongoing industrial downturn. The decline in capital utilisation in the manufacturing sector continued at a fast pace. For this reason, capacity extensions were less urgent. Other economic indicators also point to a decline in enterprises' willingness to invest. Thus, the value of domestic sales of German capital goods producers shrank substantially across the board. Moreover, the value of imported capital goods decreased considerably, although there was significant growth in motor vehicle imports. Enterprises appear to have continued to invest extensively in their vehicle fleets despite the persistently weak economic activity. This is also indicated by the number of commercial motor vehicle registrations, which edged down only marginally in the second quarter from an elevated level. This figure had increased significantly in the first quarter; due, not least, to catch-up effects following delivery bottlenecks in the second half of 2018 as a result of a new emissions standard. Registration figures for commercial vehicles even rose sharply and thus continued the

Propensity to invest likely to have diminished distinctly

strong upward growth momentum of the past months unabated.

Marked fall in construction investment

Construction investment is likely to have posted a steep decline in the second quarter of 2019. This is signalled by the turnover figures in the construction sector available up to May. On an average of April and May, these figures fell considerably short of the previous quarter after an extremely sharp rise in the first quarter due to favourable weather conditions. This turnaround was particularly marked in public construction investment.

Weak private consumption in second quarter

In the second quarter of 2019, private consumption is likely to have only slightly exceeded the level of the first quarter. One-off effects were a major factor behind the exceptionally strong growth in the previous quarter, which were no longer felt in the reporting period and thus had a dampening effect. Therefore, much the same as with enterprises, car purchases that had been prevented by the delivery bottlenecks last year were made in the first quarter, and the elevated level of new car registrations fell again in the reporting period. Retail sales, excluding motor vehicles, also provided little impetus, with sales picking up only slightly in real terms. Amongst other things, the decline in sales of do-it-yourself (DIY) and home improvement goods had a negative impact. Sales increased particularly sharply in the previous quarter as a result of favourable weather conditions. Furthermore, sales in the hotel and restaurant sector declined substantially in the second quarter after rising considerably in the first quarter. The decline in consumers' purchasing appetite in the reporting period is likely attributable in part to the fact that the growth-promoting impact of expansionary fiscal measures, which came into effect at the turn of the year, had probably already largely been felt in the first quarter.

Imports of goods down significantly

German imports of goods declined considerably in the second quarter of 2019 in real terms. Amid the weakening industrial activity in Germany, imports of intermediate and capital goods, in particular, dropped significantly. By

contrast, imports of consumer goods contracted only slightly in terms of value. In regional terms, the decline was quite heterogeneous. Only marginally fewer goods were imported from the euro area, while the drop in imports from non-euro area countries was considerable. However, it is likely that the Brexit effect described above had an impact on the import flow from non-euro area countries, too. In this context, imports from the United Kingdom slumped sharply in terms of value after picking up substantially in previous months. Excluding trade in goods with the United Kingdom, imports from non-euro area countries were markedly less short of the first-quarter figures.

■ Sectoral trends

The falling trend in industry continued at a slightly faster pace in the second quarter of 2019. Industrial output, strongly dependent on export orders, recorded a substantial quarter-on-quarter decline in seasonally adjusted terms. This means the downturn in this sector has been persisting for a year now. The strong expansion in the manufacture of computers, electronic and optical products provided impetus in the second quarter, and output in other transport equipment also rose considerably. By contrast, production declined steeply in the mechanical engineering and automotive sectors, which account for particularly large shares of industrial and construction output. Overall, the production of capital goods dropped substantially, but that of intermediate goods saw an even sharper decline. Conversely, consumer goods output dipped only slightly.

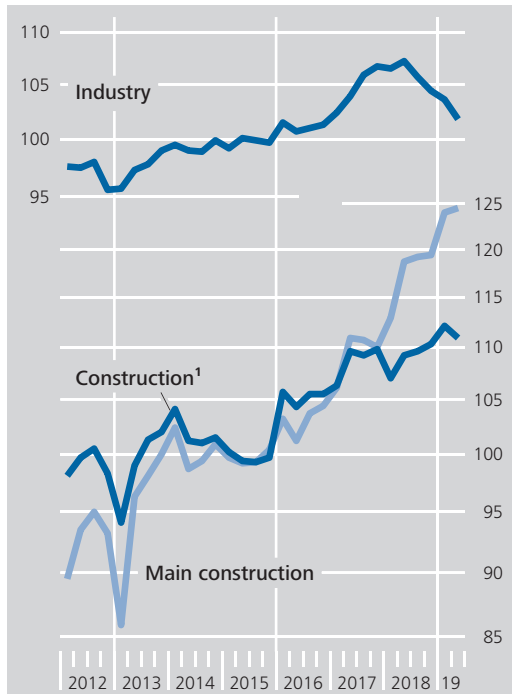
As a result of the ongoing industrial downturn, utilisation of existing production capacities continued to decrease. According to ifo Institute data, capacity utilisation of tangible fixed assets in manufacturing was down for the fourth consecutive time in the second quarter of 2019. It therefore reached a level that was last recorded over three years ago, corresponding roughly to its long-term average. In a sector

Industry still in a downturn

Accelerated decline in industrial capacity utilisation

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

breakdown, aggregate capacity utilisation in the intermediate and capital goods sector declined most sharply, whereas manufacturers of consumer goods saw only a slight decrease.

Construction output significantly down

In the second quarter, construction output was likewise down considerably on the previous quarter after seasonal adjustment. One factor at play here was the strong increase in construction activity over the winter months due to the unusually mild weather, after which output normalised during the reporting period. The decline was mainly due to the drop in finishing trades. By contrast, construction output in the construction sector showed a further marked increase. Both construction and civil engineering production experienced growth. The construction boom continued in Germany into the reporting period despite the overall decline in production. According to the ifo Institute, a high percentage of enterprises in the construction sector continued to record production hold-ups caused by a lack of skilled labour.

Economic output in the services sectors is expected to have stagnated in the second quarter of 2019. Real sales in the retail trade were up slightly on the high level of the previous quarter. By contrast, sales in wholesale trade followed the weak industrial activity and declined steeply in real terms. Moreover, business activity in the hotel and restaurant sector contracted considerably in price-adjusted terms after benefitting from high demand in the first quarter. Conversely, the motor vehicle trade reported a growth in sales. Furthermore, the activity in the other services sectors is expected to have provided some impetus. This is supported by the assessment of the business situation in these sectors, which – according to the ifo Institute – was still clearly above the long-term average in spite of a considerable downward revision.

Probably no change on quarter in services sectors

Labour market

The cyclical weakness that had already persisted for a year also left its mark on the German labour market in the second quarter. This was reflected by the considerably slower rise in employment in the reporting period than in previous quarters. In particular, this applies to the number of employees subject to social security contributions, which had previously increased sharply. In addition, unemployment did not recede any further. However, this does not mean that labour market conditions are worsening, at least for now. On the contrary, the situation remains exceptionally favourable. The only difference is that it did not improve as before and that the outlook for the next few months has deteriorated further.

Weak economy affects labour market in second quarter

In the second quarter, enterprises were considerably more reluctant to recruit than before. The seasonally adjusted number of persons in work in Germany rose by 50,000, or 0.1%, in the reporting quarter. This equates to roughly only one-third of the growth in the first quarter. Also, employment growth weakened as the reporting period progressed. As a matter of principle, these observations also apply to em-

Much slower growth in employment

ment subject to social security contributions, for which preliminary data are only available up to May 2019 and which had supported the protracted steep rise in employment growth. Furthermore, the number of self-employed persons and persons working exclusively in low-paid part-time jobs decreased again.

Manufacturing barely recruiting at all, whereas some services sectors recruiting strongly

In the first two months of the reporting quarter, the number of persons in employment subject to social security contributions was 71,000, or 0.2% above the average of the first quarter of 2019. The only economic sector in which the number of jobs subject to social security contributions significantly decreased, was temporary agency employment. The sharp decline continued that has been persisting for the past year and a half in this sector. By contrast, some services sectors continued to recruit strongly. Alongside the health and social care sector, this affected the other business and support services (not including temporary agency employment) as well as the IT sector. However, a more cautious recruitment policy can be seen in most of the economic sectors. Job growth virtually stagnated in the manufacturing sector, which has been suffering from the declining demand for industrial goods for quite some time. The increase in employment in the construction sector was also close to zero in seasonally adjusted terms. However, the usual second-quarter rebound in employment is expected to be weaker this year following the mild winter.

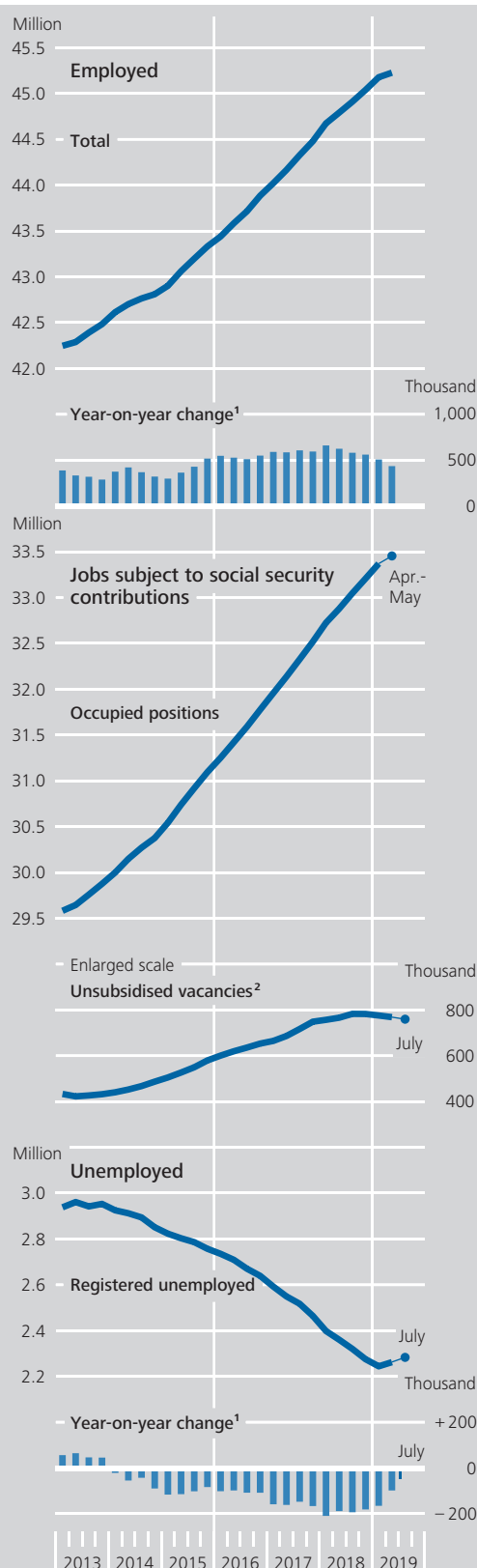
Net immigration to Germany down in first months of 2019

It is possible that the weak economic activity has already had an impact on immigration to Germany. According to the monthly migration statistics published by Germany's Federal Statistical Office, on balance, fewer persons moved to Germany from central and east European Member States in particular, in the first four months of this year.² These countries form by

² According to the migration statistics published by Germany's Federal Statistical Office available up to April 2019, Germany's migration balance with the central and eastern European EU11 amounted to 45,000 persons in this period. This corresponds to a 35% decline compared with the same period in 2018.

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.

far the most significant region of origin for economic migration to Germany. Since the citizens of these countries enjoy freedom of movement of workers, migration decisions can even be made or changed at short notice. In contrast, for example, immigration from the Western Balkans – whose citizens require a certificate from the Federal Employment Agency and a work visa in advance – increased slightly.

More unemployment in the statutory unemployment insurance scheme

Registered unemployment rose slightly in the second quarter after seasonal adjustment. On average, 19,000 more people were recorded as being unemployed in the reporting period than in the preceding quarter. This was the first quarterly increase since the end of 2013. Rounding meant that the unemployment rate remained unchanged at 5.0%. The number of unemployed was unchanged on the month in July. There was an increase in the number of people registered as short-term unemployed under the statutory unemployment system, probably for cyclical reasons. Averaged over the months of the second quarter, some 20,000 more people were registered as being out of work in this area than in the preceding three-month period. By contrast, the number of unemployed receiving the basic welfare allowance continued to drop. However, a review by the Federal Employment Agency in the facilities it runs jointly with the local governments (jobcentres) in April 2019 found that the previously reported declines had probably been overstated by 30,000 to 40,000 persons. As a consequence, levels were corrected upwards in May.³ The number of persons registered as unemployed receiving the basic welfare allowance therefore hardly fell despite the original decline in the quarter-on-quarter comparison.

More labour market policy measures, short-time working still moderate

Unemployment under the statutory unemployment insurance scheme, which is sensitive to cyclical conditions, increased only moderately, in part because active labour market policy measures were expanded modestly. In particular, there was a rise in the number of persons participating in short-term measures to get people into work and integrate them into the

job market. To a lesser extent, this is also true of government-assisted working arrangements and occupational training measures. Short-time work for economic reasons continued to play only a minor role. The rise that the ifo Institute reported at the beginning of July is not yet evident in the Federal Employment Agency's data, which are available with a greater lag.

Leading labour market indicators paint a mixed picture. The deterioration in sentiment in terms of recruitment plans continued, primarily in industry. The ifo employment barometer, which inquires about trade and industry recruitment plans over the next three months, continued to drop sharply for manufacturing. The outlook there is now predominantly pessimistic. By contrast, positive employment plans continue to dominate in the services sectors (except the wholesale and retail trade) and in construction. Other employment indicators such as the labour market barometer produced by the Institute for Employment Research (IAB) and the Federal Employment Agency's BA-X job index fell perceptibly in the reporting period after a period of high stability. Nonetheless, the number of firms planning to hire new staff still outnumbered those wishing to downsize their workforce. The figure for reported vacancies fell slightly as compared to the preceding quarter, but is still very high. Fewer vacancies were reported primarily by manufacturing and related industries such as logistics and business and support services, which include temporary agency employment. The leading indicator for unemployment in the IAB labour market barometer continued to fall and is in negative territory. Unemployment could rise over the next three months.

Leading indicators show further deterioration in sentiment

³ See Deutsche Bundesbank (2019b) or Federal Employment Agency at <https://statistik.arbeitsagentur.de/Statischer-Content/Service/downloads/Pruefaktion-gE-Status-Alo.xlsx>

■ Wages and prices

Negotiated wage growth perceptibly weaker in the second quarter

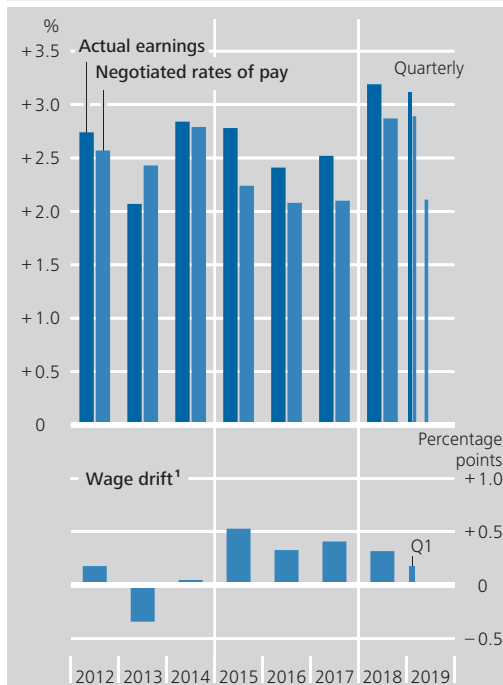
In the second quarter, negotiated wages rose noticeably more slowly than a quarter earlier. Including additional benefits, they were up by 2.1% on the year in the second quarter of 2019, compared with 2.9% in the first quarter. At an annual growth rate of 2.2%, the increase in negotiated rates of basic pay was likewise smaller than in the first quarter (3.0%). However, this is unlikely to reflect the slowdown in economic activity. In actual fact, the slower pace of growth in negotiated pay rates can primarily be attributed to the fact that the second round of incremental increases under old, long-running collective wage agreements are lower (or even non-existent). At the time they were concluded, no one could have foreseen the persistent economic downturn. Moreover, the second quarter included a number of months with no pay rise, known as “zero months”, under newly reached pay agreements. As in previous quarters, actual earnings in the second quarter probably slightly outpaced negotiated wages.

Recently agreed wage increases remain higher than under previous collective wage agreements

Recent wage agreements were primarily concluded in the services sectors. In the retail sector and in wholesale and foreign trade, for instance, employers and the trade unions agreed to lift wages by 2½% and 2¼% respectively in annualised terms. Both the commercial bank and cooperative bank sectors agreed moderate annualised wage increases of 1¼% to 1½%. Nonetheless, wage growth in these four industries was higher than under the preceding agreements of 2016 and 2017. The most recent collective agreements generally include two-step wage increases and run for 24 months or more. At the beginning, several “zero months” often dampen year-on-year rates. The wage demands for the outstanding negotiations in this year’s wage round usually amount to 5.5% to 6% over a 12-month period, as in last year’s round. Wage bargaining is currently upcoming in the insurance sector and in the plastic processing industry. Another subject of discussion is the option for employees to choose individu-

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). ¹ The wage drift is calculated as the annual change in the ratio of actual earnings to negotiated rates of pay.
 Deutsche Bundesbank

ally whether they would prefer more free time or a higher rise in wages.

Consumer prices rose strongly and across a broad base in the second quarter. A third of the overall seasonally adjusted increase in the Harmonised Index of Consumer Prices (HICP) of 0.9% on the quarter was attributable to significantly higher energy prices, which were in turn the result of rising crude oil prices. In addition, prices for food, beverages and tobacco went up perceptibly. This was mainly due to tobacco. However, even without energy and food, the upward pressure on prices was noteworthy, especially for services. First, prices for package holidays rose even more than the late Easter holidays might have suggested. Second, there was a considerable rise in prices in some parts of the services sector, e.g. maintenance of dwellings or hairdressing. This is probably attributable, in part, to marked wage inflation in these areas. The prices of non-energy industrial goods grew at a moderate pace, following de-

Broad-based and strong growth in consumer prices in the second quarter

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

velopments in upstream prices. All in all, annual consumer price inflation rose only moderately from 1.6% to 1.7%, as headline inflation had been fairly strong in the second quarter of 2018, too. Excluding energy and food, it worked out at 1.5%, up from 1.4%.

Further price increases in July, but contribution of package holidays has sharply dampening effect on annual rate

In July, prices rose further by 0.1% in seasonally adjusted terms. While energy prices were virtually unchanged, food prices were clearly higher. Prices for non-energy industrial goods, by contrast, rose only slightly, while services prices went up moderately. Overall, the annual HICP rate was down significantly, however, falling from 1.5% to 1.1%. Excluding energy and food,

the decline was even slightly more pronounced, from 1.5% to 0.9%. Noticeably lower core inflation is the result of less lively growth in package holiday prices. The latter had risen exceptionally sharply in June because Whitsuntide was late, and have now returned to normal. A much more significant factor in the drop in core inflation was that lower package holiday inflation had a disproportionately dampening impact on core inflation and headline HICP. This can be attributed to the way in which weighting adjustments to the German HICP are handled (see also the box on p. 57). However, leaving aside not only energy and food but also travel services and apparel, where prices are also particularly volatile, the annual rate of inflation remained unchanged at 1.5%.

Over the next few months, annual inflation is likely to remain at its recently somewhat lower level. The contributions of both package holidays and energy will probably initially continue to depress the annual rate. At year-end at the latest, the rate of inflation as a whole should resume its basic upward trend, however.

Inflation rates likely to initially remain only around 1% in the near future

Order books and outlook

The German economy will probably remain lacklustre in the third quarter of 2019. Total output could shrink slightly again, mainly as a result of the continued downturn in industry. According to the data currently available, industrial output is expected to contract markedly in the ongoing quarter again. Enterprises, for example, received significantly fewer orders in the second quarter than in the already weak first quarter. Moreover, ifo Institute data show that short-term output and export expectations in the manufacturing sector deteriorated further of late. The more domestically-oriented sectors have thus far largely bucked this downward trend and have supported the economy. The boom in the German construction sector is likely to persist. Enterprises in some services sectors were less confident about the future recently, however. Although households' income

German economy set to remain lacklustre in the third quarter

Dampening special effect in the HICP in July 2019

In July, German inflation according to the Harmonised Index of Consumer Prices (HICP) differed markedly from that measured by the national Consumer Price Index (CPI). Whereas the HICP, which is relevant for European monetary policy, rose by 1.1% year on year, the CPI saw a much stronger increase of 1.7%. It is not unusual for the annual rates of change of these two measures of German consumer price inflation to differ. One reason are methodological differences, for instance in how the underlying basket of goods and services is defined, or in the index concept used.¹ Nonetheless, the CPI and HICP evolve very similarly in most cases. For example, their year-on-year rates had never differed by more than

0.2 percentage point between 2015 and 2018 at the time of publication.²

The exceptionally large deviation between the HICP and the CPI rate reported in July results from the package holidays component.³ Although this component was unchanged year on year, it accounted for a strong negative contribution of -0.5 percentage point to the headline HICP rate. By contrast, the contribution of the package holidays sub-index to the headline CPI rate was virtually zero. The counterintuitive negative contribution of package holidays to the HICP in July stems from the fact that the weight of this component was changed discernibly within the weighting scheme, in combination with the pronounced intra-year fluctuations of the series. Actually, the HICP weight for package holidays was reduced from 4.1% in 2018 to 2.7% in 2019.⁴ The CPI share of package holidays, on the other hand, has remained at 2.7% since 2015, the current base year.

In the HICP, which is a chain index, the counterintuitive negative effect of package

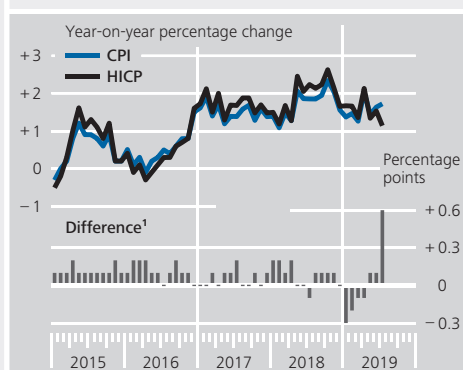
¹ Unlike the HICP, the CPI also covers owner-occupied housing and gambling. Moreover, the CPI is a price index with a weighting scheme adjusted only at intervals of usually five years, when a new base year is introduced. The HICP, by contrast, is a chain-linked Laspeyres-type index; its weights are always updated to December of the previous year. As a rule – as with the CPI – new information from the Federal Statistical Office’s Sample Survey of Income and Expenditure (EVS) is taken into account every five years. What is more, national accounts data are also used, and the HICP weights of all components are adjusted annually according to their relative price developments. This means that goods and services with above-average price dynamics are given a higher weight the following year.

² Methodological changes or the inclusion of new items in the basket of goods and services can lead to substantial deviations. These changes often occur when a new CPI base year is introduced, with the CPI data being calculated back three to four years to the new base year. The HICP is not revised as a matter of principle. Moreover, differences in the practices of linking indices with methodological breaks can result in marked discrepancies between the HICP and the CPI. See, for example, Deutsche Bundesbank (2013).

³ In this context, the Federal Statistical Office (2019) cites in its press release a “special methodological effect concerning package holidays in the HICP”.

⁴ At the level of four-digit codes in the ECOICOP (European Classification of Individual Consumption by Purpose) the weights had previously undergone similarly large changes for only four sub-components (rents and garments in 2000; gas and heat energy in 2015), which show a markedly lower volatility than package holiday prices.

Comparison of HICP and CPI



Sources: Federal Statistical Office and Bundesbank calculations.
¹ Difference between CPI and HICP at the time of publication (real-time data).
 Deutsche Bundesbank

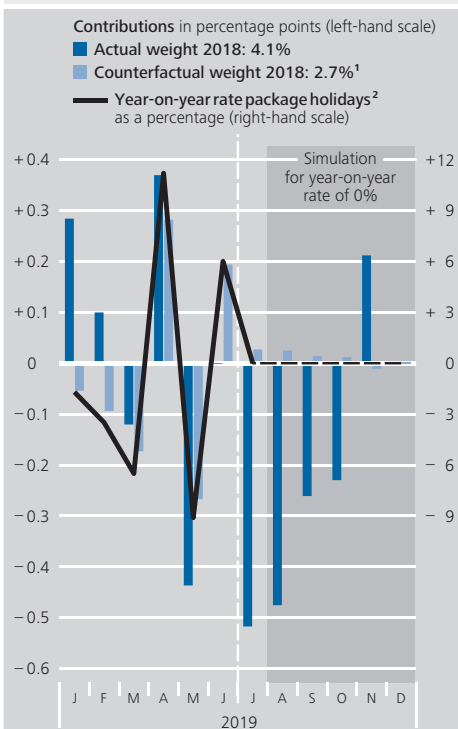
HICP sub-index package holidays and changing weight

2015 = 100, log scale



Source: Federal Statistical Office.
 Deutsche Bundesbank

Contribution of the sub-index package holidays to HICP: counterfactual simulation*



Sources: Federal Statistical Office and Bundesbank calculations.
 * The difference of the contributions to the year-on-year rate of the headline HICP based on the actual and the counterfactual weight can be interpreted as a bias. **1** Assumption that the weight in 2018 would already have been equivalent to the weight in 2019. **2** Assumption that the index values of the HICP sub-index package holidays from August to December 2019 are identical to those of the previous year. In the event of other index values for these months, the light blue and the dark blue columns would each change by the same value; the bias is therefore already known until the end of the year.
 Deutsche Bundesbank

holidays in July 2019 can be illustrated as the contribution of two opposing price movements within the last 12 months. Each of these movements refers to December 2018, through which the price data for 2018 and 2019 are linked in the HICP.⁵ Prices for package holidays, which have their seasonal high in the summer months, fell considerably between July 2018 and December 2018. Prices then rebounded by a similar magnitude until July 2019. However, last year's decline in prices statistically feeds into the annual inflation rate with the relatively high HICP weight of 2018 (4.1%), whereas the similarly high price increase in the current year feeds into the annual inflation rate with the lower HICP weight of 2.7%. On balance, therefore, the negative price development of package holidays last year outweighs the positive development this year, dampening the year-on-year HICP rate in July 2019. If, on the other hand, the weight for package holidays had remained constant in 2018 and 2019, package holidays in the HICP – as in the CPI – would have accounted for a contribution to the July headline rate of close to zero. The HICP rate would then have turned out distinctly higher.

Counterintuitive growth contributions from the HICP sub-index package holidays were already being observed at the beginning of the year, although they were not as pronounced as in July.⁶ The statistical one-off effect of the HICP sub-index package holidays will have an impact on the headline rate in the months ahead, too. Negative ef-

5 A sub-component's contribution to the annual rate of the chain-linked HICP can be further broken down into a this-year term and a last-year term using the so-called Ribe formula. See Chapter 8 in Eurostat (2018).

6 The HICP sub-index package holidays fell by 1.7% in January and by 3.5% in February on year. However, in those months it made a positive contribution of 0.3 and 0.1 percentage point respectively to the headline rate.

fects will continue until October, when they will gradually subside, giving way to a positive effect in November. The statistical one-off effect will not cease until December 2019.

To sum up, the large discrepancy between the CPI and HICP inflation rate in July 2019 is largely due to a statistical one-off effect resulting from the approach taken to revise the component package holidays in the HICP. When the new base year was introduced for the CPI this year, by way of exception the official statistics producers also revised package holidays in the HICP back to January 2015.⁷ However, they refrained from making a concurrent adjustment to the corresponding HICP weight from 2015.⁸ For this reason, when using the HICP to assess current inflation dynamics in Germany and the euro area, it is important to keep in mind that all inflation rates containing the

sub-index package holidays are distorted in the current year because of the strong weight adjustment for package holidays that was not consistent with the revision of the index series.⁹ As a result, annual HICP inflation excluding energy and food in Germany and the euro area in July was markedly biased downwards, by 0.7 percentage point and 0.2 percentage point respectively.

⁷ See Eurostat (2019) and Deutsche Bundesbank (2019a).

⁸ The new HICP sub-index package holidays has a completely different seasonal pattern than prior to the revision. As a result, the relative price relationship between the HICP sub-index package holidays and headline HICP changed in December of the years 2015 to 2018. In the case of a chain-linked index with December as the linking month, this relationship plays an important role in the annual adjustment of the weights. It would therefore have been consistent, when revising the HICP sub-index package holidays, to revise also its weight and all the other weights of the HICP sub-indices.

⁹ For more information on the generally high impact of package holiday prices on the German core inflation rate, see also Deutsche Bundesbank (2017).

prospects remain favourable, the economic downturn has now also started to leave its mark on the labour market. Future developments will depend on how long the present economic dichotomy lasts and which direction the economy takes once it dissolves. As things currently stand, it is unclear whether exports and, by extension, industry will pick up before the domestic economy is hit any worse.

According to the ifo Institute, sentiment in the German economy became much gloomier in the period under review. The business climate index deteriorated again, having stabilised temporarily during the winter months. The dichotomy between the view taken by enterprises in industry and those in the services sectors excluding retail lessened somewhat. On the one hand, sentiment in industry remained considerably less favourable than in the economy as a whole, and pessimism continued to rise. Here, the assessment of business conditions, which has been falling for one-and-a-half years, de-

teriorated particularly sharply. The business expectations of industrial enterprises fell comparatively little, but are meanwhile well below their longer-term average. On the other hand, the confidence of enterprises in the wholesale trade and in other services sectors fell considerably in the period under review. Sentiment in the retail trade, meanwhile, was still able to buck the downward trend. This was due, in particular, to the assessment of the business situation within the industry, which improved sharply in recent months and was consequently only slightly below the high it reached shortly after German reunification. Similarly, optimism in the construction sector was unchecked.

German industry continued to suffer from falling demand in the second quarter of 2019. Industrial new orders were down again significantly on the first quarter, in which the orders situation had already deteriorated quite considerably. The inflow of orders excluding large orders, which are often received at irregular

Sentiment remains on a downward trajectory

Industry continues to face falling demand

Demand for industrial goods and construction services

Volumes, 2015 = 100, seasonally adjusted, quarterly data



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

intervals and therefore paint a less accurate picture of the underlying cyclical trend, fell even more sharply. In terms of their geographic origin, new orders from Germany and the euro area were the main reason for the overall decline. Weak demand for motor vehicles and machines was striking in these regions.⁴ Orders from non-euro area countries, by contrast, rose sharply overall. However, large orders made a particularly large contribution here. Without these large orders, incoming orders from these countries did not exceed the severely depressed level of the previous quarter either. Against this backdrop, German industrial enterprises' order books are currently emptying rapidly. According to ifo Institute information, the assessment of the stock of orders still being processed in manufacturing has, for instance, been falling continuously for more than six months and is now below its long-term average. The data on industrial orders on hand provided by the Federal Statistical Office point in the same direction.

The boom in the German construction sector is likely to continue. However, construction output is not expected to expand sharply over the third quarter given supply-side constraints within the industry. During the period under review, equipment utilisation in the main construction industry was only slightly down on its peak levels, according to the ifo Institute. Skilled labour also remains in very short supply. By contrast, demand for construction work is still strong. Averaged across April and May – the most recent months for which statistics are available – incoming orders in the main construction sector went down steeply on the

Construction boom likely to continue in the third quarter

⁴ It is not clear whether the poor orders situation in the automotive industry has anything to do with a further tightening of certification rules. From September 2019, additional rules on evaporative emissions (EVAP) set new limits for such emissions. Like last year, when a new emissions testing procedure was introduced, the consequence is likely to be that automotive manufacturers will have to carry out more controls in the type approval procedure. This could again result in delivery bottlenecks for passenger cars fresh from the assembly line. However, the problems are unlikely to be as severe as last year.

previous quarter after seasonal adjustment. They have thus been on the decline since the beginning of the year. However, it should be noted that construction enterprises reported an exceptionally large number of new orders in the final quarter of 2018. These included numerous large orders, which come in at irregular intervals and have an above-average range. The reach of order backlogs in the main construction sector overall remains at an extremely high level, according to ifo Institute surveys.

Private consumption looks set to expand more strongly again in the third quarter of 2019. The labour market is showing first signs of a slowdown given weak industrial activity, with unemployment not coming down any further of late, and the increase in the number of persons in work slowing noticeably. Overall, however, consumers' outlook for the labour market and incomes remains very favourable. This is also evident in the GfK consumer confidence index, which remains high despite a moderate drop.

Private consumption likely to expand more strongly again in the third quarter

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