

Global and European setting

Global economic developments

Global economic growth remains moderate

The global economy likely expanded in the third quarter of 2019 at a similar rate to the second quarter. This means that the upturn in economic activity predicted in a number of forecasts has not yet materialised. Of the major economies, the United States was once again characterised by robust aggregate output growth in the third quarter, while the UK economy recovered from its second-quarter setback. In the euro area, economic growth was muted once again, and growth in Japan came to a virtual standstill. In China, the gradual moderation of growth continued, and in other large emerging markets economic activity remained mostly subdued.

The ongoing moderate growth in the global economy was chiefly attributable to the sluggishness in global industry, which has barely expanded its production since the first quarter of 2019. Although the global purchasing managers' index for the manufacturing sector has picked up again somewhat in recent months, it has not reached the expansion threshold. At the same time, there have been increasing indications that the slowdown in industry is spreading to the services sector (see the box on pp. 11-12). One aspect that was weighing on global economic activity until recently was the trade conflict between the United States and China. In the past few weeks, however, there have been some signs of easing tensions.¹ According to the underlying trend, global trade remained listless until recently, despite a slight recovery in July and August.

Protracted sluggishness in industry, with risk of spillover to services sector

Global industrial output and world trade

2015 = 100, seasonally adjusted, quarterly, log scale



Source: Centraal Planbureau.
 Deutsche Bundesbank

In light of these developments, the latest projections from the International Monetary Fund (IMF) could have been somewhat too optimistic. Although the IMF staff revised its growth projections for 2019 and 2020 markedly downwards once again,² it held on to its expectation that global economic activity would pick up in the second half of 2019. In particular, the stabilisation of the difficult overall economic situation in some emerging market economies is expected to lift the growth rate of the global economy (based on purchasing power parity weightings) from 3.0% this year to 3.4% next year. Moreover, the expected recovery in global economic activity will depend on the impact of the supporting economic policy measures – primarily the accommodative monetary policy in

IMF revises projections for global growth downwards once again, but anticipates a certain upturn

¹ In mid-October, US President Donald Trump announced that a fundamental understanding between the two countries had been reached with regard to an agreement that would, above all, boost Chinese purchases of US agricultural products. The agreement, which has not yet been signed, is intended to pave the way for a more comprehensive trade agreement that will cover other contentious issues.
² See International Monetary Fund (2019).

The two-speed global economy

The global economic expansion, which had previously been vibrant, has distinctly lost steam over the past year and a half. The deceleration has been particularly pronounced in the manufacturing sector, where production growth has recently come to a virtual standstill.¹ In other sectors, however, gross value added seems to have continued to expand at comparatively constant rates.² This “two-speed” global economic growth is also reflected in the results of business surveys. Whereas the global purchasing managers’ index (PMI) for manufacturing has dropped considerably since the turn of 2017-18 and has even temporarily shown a contraction in production, its services counterpart has remained quite solidly above the expansion threshold. On balance, a sizeable gap has opened up between the two indicators.³ In the euro area, where the situation in manufacturing had been assessed particularly favourably in 2017, the indicator fell even more significantly. This led to a rather sizeable sentiment gap, which had last been observed in the aftermath of the global financial and economic crisis.

The diverging developments in the manufacturing and services sectors are likely to reflect a change in the composition of global demand, with investment dynamics

slowing down distinctly in the past few quarters. The volume of global trade has even been trending downwards for nearly a year now. This has particularly affected the manufacturing sector, which is export-oriented and geared towards the production of capital goods.⁴ By contrast, many branches of the services sector are more frequently used by households. Accordingly, this sector has benefited more from the relatively robust consumption activity.

For the economic outlook, the degree of vulnerability of the services sector to potential contagion from the flagging industrial sector plays a major role. For instance, in the latest edition of its World Economic Outlook, the IMF points to spillover effects from manufacturing as a key downside risk to the world economy.⁵ Based on past experience, this concern appears to be justi-

¹ According to data provided by the Dutch economic research institute Centraal Planbureau, global industrial production was up by merely 0.4% on the year in August 2019. This contrasts with a figure of more than 4% at the beginning of 2018.

² In the euro area, for instance, gross value added in manufacturing was down in the second quarter of 2019 by 1.1% on the year. Most other sectors saw growth rates ranging from 1% to 5%.

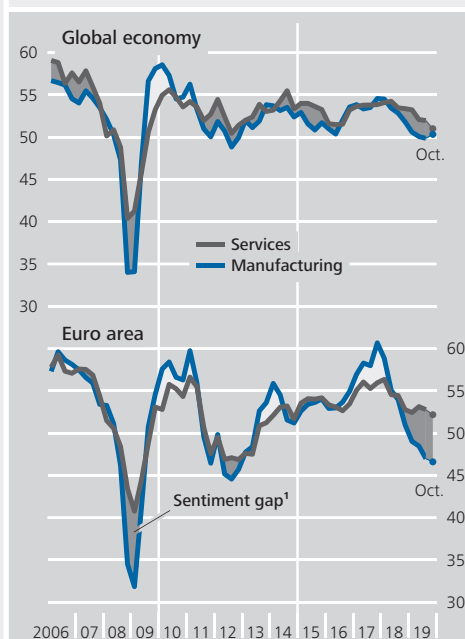
³ Among those countries that publish comparable PMIs, only in Brazil and India was production growth in manufacturing assessed more favourably than that in services in the third quarter of 2019.

⁴ According to OECD estimates, some 40% of manufacturing output in the G7 economies is produced to meet domestic investment demand and for exports. The corresponding share of services output is not even half this amount. See OECD (2019).

⁵ See International Monetary Fund (2019).

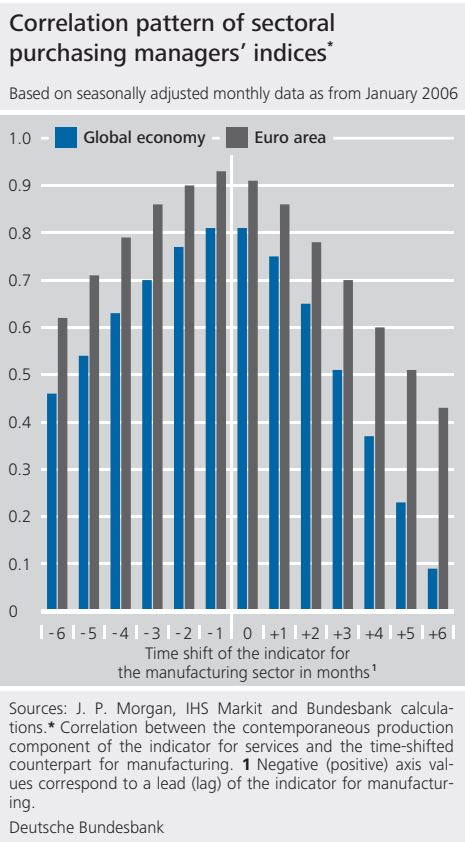
Sectoral purchasing managers’ indices*

Index points, quarterly, seasonally adjusted



Sources: J. P. Morgan, IHS Markit and Bundesbank calculations. * Sub-index for production. ¹ Dark shading indicates worse and light shading indicates better survey results for the manufacturing sector.

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fied. Historically, there has been strong comovement between the sectoral PMIs over time, both globally and in the euro area. Substantial differences regarding the assessment of production trends have appeared on numerous occasions. However, they have rarely been long-lasting. Turnarounds in manufacturing have often preceded similar changes in sentiment in the services sector. This dynamic correlation pattern has also shown up in phases similar to the current situation. Both in the period from the fourth quarter of 2011 to the first quarter of 2012 as well as in the second and third quarters of 2015, purchasing managers' sentiment in global manufacturing was subdued, whereas the survey results for services held up better. In both cases, the subsequent closing of the sentiment gap was initially triggered by a deteriorating assessment of services, after which the macroeconomic situation ultimately improved.

There are, in fact, currently signs that the slump in industry is spilling over to services, especially into those sectors which are closely interlinked with manufacturing through value-added chains. Over the course of the past year, sentiment was already dipping markedly among firms specialised in supplying business-related services.⁶ In the euro area, the production indicators for this segment are already hinting at a slowing expansion.

Going forward, indirect transmission channels could also take on greater importance, with employment growth, in particular in the industrial sector, slowing in many places over the past few quarters. Survey-based indicators are pointing to a further decline, which is spilling over to other sectors.⁷ Should the labour market situation actually deteriorate, this will likely also impair the outlook for growth among consumption-related service providers.

These contagion effects could be amplified if industrial activity fails to regain traction soon or even takes a turn for the worse. Against this backdrop, it is a positive sign that the global PMI for manufacturing has undergone a slight recovery in the past few months and its counterpart for the euro area has at least stabilised.⁸ Consistent with these assessments, the Bundesbank's leading indicator for the global economy is showing that industrial activity may possibly have bottomed out. However, there are no signs yet of major improvement.

⁶ This is reflected, inter alia, in a gloomier assessment of production growth. By contrast, the corresponding survey results for consumption-related services and the financial sector saw little decline.

⁷ For instance, since as long ago as May 2019, the employment component of the global PMI for manufacturing has remained stuck below the expansion threshold of 50 points. At last report, the PMI for the services sector was just slightly above this mark.

⁸ This development, however, has been accompanied by a further deterioration in sentiment in the services sector, meaning that the global gap between the sector indicators was nearly entirely closed in October.

many countries – not being jeopardised by the emergence of risks such as a further escalation of trade disputes.

Commodity prices largely moving sideways

Against the background of persistently moderate global economic activity, crude oil prices trended sideways over the course of the reporting period. Although crude oil prices jumped by 15% in the aftermath of production losses in Saudi Arabia resulting from an attack in September, they promptly reverted to their previous level as production in Saudi Arabia normalised faster than anticipated. In addition, large global oil stocks had a stabilising effect and are indeed likely to have been able to offset the supply deficit for some time. This applies even more given the International Energy Agency's expectation that the crude oil market will have a tendency to be oversupplied next year.³ As this report went to press, the spot price for a barrel of Brent crude oil was, at US\$63, only marginally higher than in August. Futures were still trading at marked discounts across the entire range of maturities. According to the HWWI index, prices for non-energy commodities were likewise essentially unchanged from the levels they had reached in mid-August.

Rising core inflation in industrial countries

Energy prices caused price inflation in industrial countries to decrease markedly over the past few months to a fairly subdued level of 1.3% on the year in September. By contrast, the core rate excluding energy and food rose slightly over the same period to no less than 1.8%.

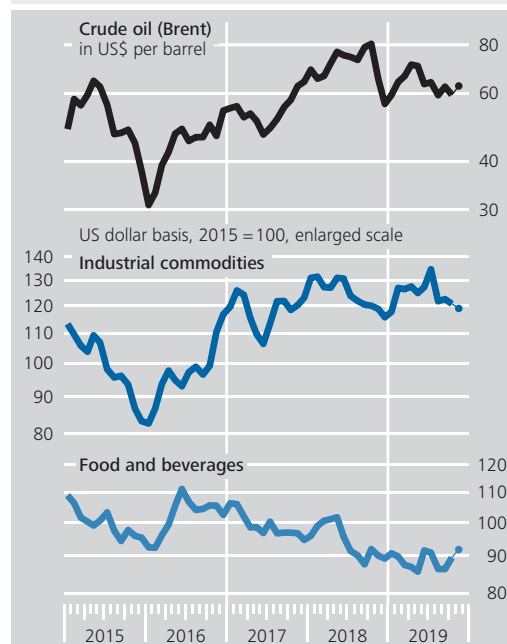
Selected emerging market economies

Chinese growth gradually moderating further

According to official data, annual real growth in China's gross domestic product (GDP) decelerated to 6% in the third quarter. The gradual slowdown in growth that began in the second quarter of 2018 has thus continued. The fairly weak international environment continued to act as a major drag on growth. In the past quarter, revenues from goods exports to the United States were down by 15% in US dollar

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 8 November 2019, or 1 to 14 November 2019 for crude oil.

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terms chiefly due to the trade dispute. Exports to other countries likewise remained lacklustre. In order to support economic activity, the Chinese government has ushered in various expansionary measures since the beginning of the year. These focused on strengthening households' purchasing power. For example, income tax and value-added tax were lowered. For consumers, however, this tax relief was eaten into by considerable rises in expenditure for food. In particular, pork prices surged in recent months due to rampant swine fever. As a result, the rate of inflation as measured by the consumer price index (CPI) increased significantly in October to 3.8%. This was the sharpest rise in prices since the beginning of 2012.

In India, economic activity in the third quarter, for which there is not yet an official GDP estimate, is likely to have lost more momentum. In

³ See International Energy Agency (2019).

Economic activity in India likely to have lost more momentum

the second quarter, GDP growth had already fallen considerably to 5% on the year. The crisis in the Indian shadow banking industry was the main reason behind this renewed slowdown. Shadow banks play an important role in the supply of credit to households and small enterprises in India. This is especially true for motor vehicle financing. As a result, sales of passenger cars dropped by 30% on the year in the third quarter. Industrial production also fell below the previous year's level due to the slumping motor vehicle sector. At 3.5%, annual consumer price inflation in the previous quarter remained fairly weak by Indian standards. In light of the dampened inflationary pressures and the tensions in the financial sector, the Reserve Bank of India maintained its accommodative stance.

Recovery in Brazil appears to be continuing

In Brazil, economic output is likely to have seen moderate growth again in the third quarter after rising in the second quarter by a seasonally adjusted 0.4% on the quarter. Output in the mining sector, which had experienced massive losses as a result of a dam collapse at the beginning of the year, largely returned to normal levels. Sentiment among purchasing managers in the manufacturing sector also brightened noticeably. In addition, the major pension reform passed in October improved the long-term prospects for Brazilian public finances. In light of the persistently restrained annual consumer price inflation, which was 2.9% in September, the Central Bank of Brazil once again loosened its monetary policy to a considerable degree. This move left the policy rate at a record-low 5%.

Underlying cyclical trend remains muted in Russia

The Russian economy built up distinct momentum in the third quarter. According to an initial estimate by the Russian Federal State Statistics Service, real GDP saw annual growth of 1.7% after having recorded gains of just 0.9% in the second quarter. This stronger growth is likely to have been largely attributable to one-off factors, such as a plentiful harvest in particular. Until recently, growth in private consumption had been highly subdued and was likely to

have still been restrained by the value-added tax hike introduced at the beginning of the year. Investment activity likewise remained weak. The implementation of what are known as "national projects" – which comprise an ambitious, medium-term infrastructure programme⁴ – has seen only sluggish progress so far. Consumer price inflation fell to 4.3% on the year in the third quarter. Against this backdrop, the Bank of Russia cut its policy rate in four steps by a total of 125 basis points to 6.5% at the end of the reporting period.

United States

In the United States, the robust overall economic upturn maintained its pace and continued in the third quarter. According to an initial official estimate, real GDP was again up by 0.5% from the preceding quarter. Burdens imposed by foreign trade and changes in inventory, which had previously hampered growth, did not persist. Growth in domestic final demand, however, was not entirely able to maintain the rapid pace seen in the second quarter. The renewed decline in industrial gross fixed capital formation played a role in this context.⁵ In addition, public demand and private consumption grew less strongly. This contrasted with an upturn in private housing construction – in some cases, the weakness in this sector had been interpreted as a harbinger of a potential recession.⁶ Against the background of more favourable financing conditions, housing construction investment saw marked expansion again for the first time in almost two years. This recovery could continue in the coming quarters, especially as the US Federal Reserve System lowered the fed funds rate by an add-

Continued solid economic growth

⁴ The Russian government has designated funds corresponding to just under US\$400 billion for the investment programme up until 2024. The programme is intended to focus on expanding the road network, the rail network, seaports and airports.

⁵ In this context, sharp declines were again recorded in the mining and aviation sectors. However, investment dynamics remained listless in other sectors, too.

⁶ See Emmons (2018, 2019).

itional 25 basis points at the end of October. The persistently good situation on the labour market is also likely to continue to prop up household demand. At the start of the fourth quarter, the unemployment rate remained at the very low level seen in the third. In line with this, domestic inflationary pressures were still fairly strong until recently. In October, the annual growth rate of CPI excluding energy and food stood at 2.3%.

Japan

Growth almost comes to standstill

In Japan, economic growth almost came to a standstill in the third quarter. According to an initial official estimate, seasonally adjusted real GDP grew by only 0.1% over the previous period after still having risen fairly briskly in the two preceding quarters. Despite the anticipatory effect in the run-up to the increase in value-added tax on 1 October 2019, the rate of private consumption growth in the third quarter could not quite match that of the preceding period. By contrast, industrial investment and expenditure for private housing construction were expanded to a greater degree. Private final demand, which was fairly brisk on the whole, was partially serviced using stockpiled goods, however. Furthermore, the decline in exports took its toll on economic output. Despite a slight increase, the rate of unemployment remained at an exceptionally low level in September. Although the labour market situation continued to be favourable, wages still saw virtually no growth compared to the previous year. Accordingly, consumer price inflation remained subdued. In September, the annual rate of change in CPI excluding energy and food stood at 0.3%. Against this backdrop, the Bank of Japan maintained its accommodative stance.

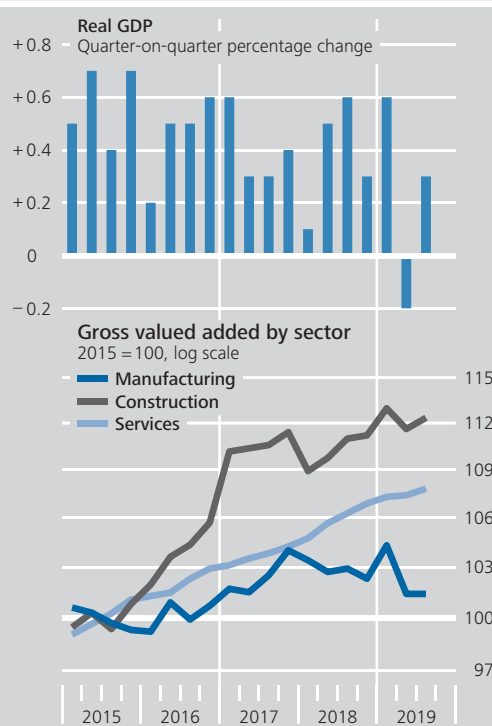
United Kingdom

Economic output rises again

UK economic output rose again in the third quarter. According to an initial estimate, real

Economic output in the United Kingdom

Seasonally adjusted, quarterly



Source: Haver Analytics. Original source: Office for National Statistics.

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GDP grew by a seasonally adjusted 0.3% over the previous quarter after having contracted slightly further in the second quarter. Key to this was a slight improvement in growth in the services sector, which makes a significant contribution to national gross value added. In addition, production in the manufacturing sector stabilised; this sector had been in sharp decline in the previous period due to the United Kingdom's planned withdrawal from the EU, which had originally been scheduled for the end of March. Construction activity also recorded distinct growth. The situation on the labour market still appeared exceptionally good; in the third quarter, unemployment was, at its lowest level so far in the current cycle. The year-on-year change in the Harmonised Index of Consumer Prices (HICP) fell to 1.5% at the current end. Although the contours of an orderly exit of the UK from the EU have become more clearly visible in light of the renegotiation of the Withdrawal Agreement in October, sentiment amongst entrepreneurs and consumers

deteriorated markedly towards the end of the reporting period. Even in the event of an exit under these conditions, the National Institute of Economic and Social Research (NIESR) anticipates considerable GDP losses of around 3½% compared with the UK remaining a member of the EU.⁷

Poland

Upturn continuing, marked rise in consumer prices

In Poland, economic expansion picked up steam again in the third quarter. Real GDP grew by 1.3% from the preceding quarter after seasonal adjustment. This growth was bolstered by the ongoing favourable labour market situation, the continued strong wage growth and the additional social benefits ahead of parliamentary elections. The unemployment rate declined further in the third quarter to just 3.3% after seasonal adjustment. Nevertheless, the Polish economy did not remain unaffected by the global slowdown in the industrial sector. Industrial production contracted by a seasonally adjusted 1.3% compared with the preceding quarter, and industrial confidence fell to its lowest level since the start of 2017. Inflation firmed distinctly. The consumer price index (CPI) increased by 2.6% in September on the year; excluding energy and food, this figure stood at 2.4%. The core rate one year earlier had been 0.8%. The Polish central bank left its policy rate unchanged as before.

Macroeconomic trends in the euro area

Economic growth only moderate

According to Eurostat's flash estimate, euro area GDP grew in the third quarter, as in the second, by 0.2% on the quarter after seasonal adjustment. After having risen by 0.4% in the first quarter, which was also due to temporary one-off effects, the underlying pace is likely to be assessed as somewhat lower than in the first half of the year. The further decline in the sentiment indicators suggests this as well. Annual GDP growth remained unchanged at 1.2%

in the third quarter, and thus lagged slightly behind the potential growth rate of 1.3% estimated by the European Commission. The main reason for this merely moderate economic growth was the ongoing downturn in the manufacturing sector. This was weighed down by lacklustre global investment dynamics, in part as a result of the elevated risk stemming from still simmering trade disputes. The weakness in the industrial sector also spilled over to services sectors in business-related areas. By contrast, favourable financial conditions as well as the continuing resilient growth in household income provided support. So far, there are no indications that economic growth in the euro area could accelerate distinctly in the fourth quarter of 2019 and the first quarter of 2020. Instead, the business climate in the industrial and services sectors faltered slightly yet again in October, and the negative factors emanating from the global setting persisted.

Consumption activity has been rather robust so far when compared with the subdued aggregate growth. Private consumption growth is likely to have been moderate in the third quarter as well. Retail sales, after price and seasonal adjustment, were up less strongly in the third quarter than in the second quarter, while the number of new motor vehicle registrations rose steeply.⁸ The underlying conditions for private consumption also remain favourable given the positive labour market situation and the distinct increase in real disposable income. That said, households' expectations regarding future economic developments deteriorated according to the European Commission's survey. This might have prompted additional saving.

Moderate growth in private consumption

Investment in the euro area (excluding Ireland) also presumably continued to go up, albeit not

Investment up less strongly

⁷ See National Institute of Economic and Social Research (2019). According to NIESR, some of these losses expected over the medium term have already materialised as a result of uncertainty effects.

⁸ It may also be connected to the switchover to the new emissions standard EVAP (Evaporative Emissions) as of September. At all events, the number of registrations rose steeply in August and then dropped off in September.

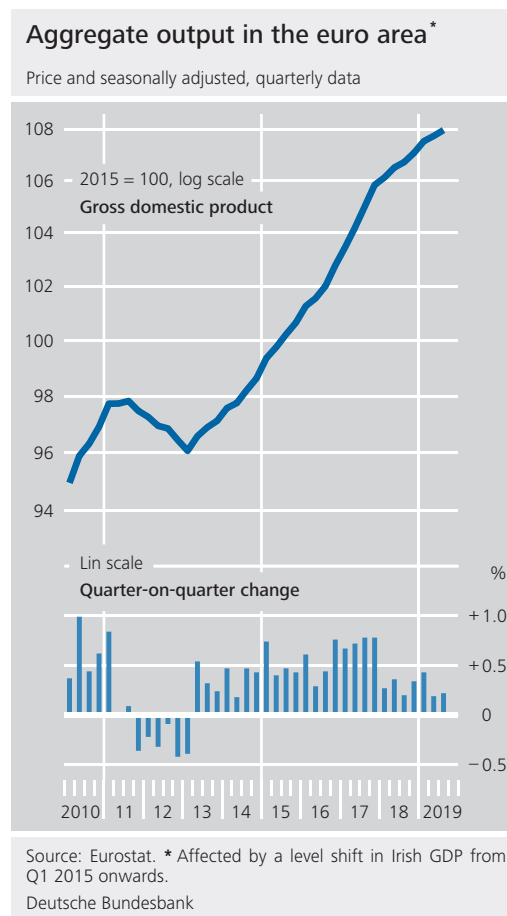
at the same pace as in the preceding quarter.⁹ In any case, the domestic sales achieved by capital goods producers grew markedly in July and August, and imports of capital goods from the rest of the world picked up significantly. Positive financing conditions and fiscal investment incentives in some countries¹⁰ are likely to have been beneficial and to have mitigated flagging industrial capacity utilisation. Construction investment, on the other hand, does not appear to have exceeded the previous quarter's levels. At all events, construction output stagnated in July and August. The European Commission surveys likewise point to a slackening in construction activity in the third quarter.

Exports to third countries up in value only slightly

On the whole, foreign trade remained lacklustre in the third quarter as well. While exports of goods to non-euro area countries increased slightly in terms of value after seasonal adjustment, intra-euro area trade tailed off markedly. Exports to the United States remained brisk, and deliveries to the United Kingdom recovered from their second-quarter setback.¹¹ However, exports to China were down for the second consecutive quarter. As export prices barely changed, the volume of exports to non-euro area countries is also likely to have picked up somewhat. Consumer goods exports, in particular, increased in July and August (including food and pharmaceutical products), while exports of capital goods fell considerably for the third time in succession. The reduction in intra-euro area trade primarily impacted intermediate goods. This reflects the great importance of cross-country value chains in the euro area's manufacturing sector. In contrast, intra-euro area trade in consumer goods saw a visible increase. Imports from third countries remained sluggish, though there was a rise in capital goods imports.

Further decline in industrial production, slowdown in services growth

The downward slide in industrial production continued in the third quarter. The production of intermediate goods saw an especially sharp decline. This area has been mired in a slump since the start of 2018. Likewise, consumer



goods output also went down considerably, although the production of capital goods experienced a distinct increase. In this context, the number of passenger cars rolling off assembly lines continued to decrease markedly, while the manufacture of other transport equipment was stepped up. The momentum in the services sectors waned somewhat in July and August. The level of activity in the transport sector and among professional, scientific and technical services is likely to be affected more and more by the sluggish activity in the industrial sector.

⁹ For the euro area as a whole, gross fixed capital formation is likely to have decreased in the third quarter as Ireland had again recorded considerable investment in intellectual property rights in the preceding quarter. Gross fixed capital formation in Ireland has been very volatile for several years due to the activities of multinational enterprises. By excluding Ireland from the analysis, the cyclical trend in the euro area becomes more apparent. See Deutsche Bundesbank (2018).

¹⁰ This includes, in particular, the special depreciation rules reintroduced in Italy in April.

¹¹ This was due to increased stockpiling prior to the original date scheduled for the United Kingdom's withdrawal from the European Union.



Pace of growth stable in many Member States compared with preceding quarter

In the third quarter, many Member States had similar GDP growth rates to the preceding quarter. The French economy maintained its moderate growth with a rise of 0.3% compared with the second quarter. The increase in private consumption accelerated slightly. Investment picked up again distinctly, albeit at a somewhat less buoyant pace than in the previous quarter. Exports rose again after a period of weakness, and imports even expanded significantly. Italy recorded a small increase in economic activity, as in the preceding quarter. The biggest contribution to growth probably came from investment activity, which had been boosted by special depreciation rules reintroduced in April. That said, private consumption is likely to have expanded moderately at most. In any event, real retail sales were up only slightly in the third quarter. On the other hand, goods exports, which had still been supporting economic activity in previous quarters, contracted after adjustment for prices. In the third quarter, the Spanish economy grew again by

0.4% on the quarter. Investment in machinery and equipment as well as private consumption picked up steam again after a weak previous quarter. By contrast, exports recorded a distinct decline here, too. Imports increased significantly in line with buoyant domestic demand. The Netherlands, Belgium and Austria likewise recorded virtually unchanged GDP growth rates.

The sluggish cyclical development is becoming increasingly noticeable in the euro area labour markets. According to Eurostat's flash estimate, the number of persons in employment rose in the third quarter by a mere 0.1% on the quarter after seasonal adjustment, and the number of unemployed persons decreased by just 70,000. However, the standardised unemployment rate of 7.5% also exceeded its cyclical trough prior to the global financial and economic crisis by just 0.2 percentage point. Labour shortages in the manufacturing and services sectors were still perceived as constraints, albeit no longer to the same extent as in the first half of the year. Wage growth is likely to have weakened slightly in the third quarter.

Only slight improvement in labour market situation

Consumer prices in the euro area rose moderately in the third quarter by 0.2% on the quarter after seasonal adjustment after still seeing strong growth of 0.5% in the second quarter. Energy prices, which had declined markedly due to low crude oil prices, were a key factor in this slowdown. By contrast, food prices rose even more sharply than in the preceding quarter. Consumers also had to pay noticeably more for services, while prices for non-energy industrial goods increased only slightly. Annual consumer price inflation (HICP) dropped considerably from 1.4% to 1.0%. Amongst other things, this was due to a base effect caused by the extremely sharp rise in energy prices in the third quarter of 2018. The rate excluding energy and food contracted from 1.1% to 0.9%, which was largely attributable to a statistical one-off effect in the German sub-index for package holidays.¹² If the prices for the volatile travel and

Energy and statistical one-off effect dampening consumer price inflation in Q3

¹² See Deutsche Bundesbank (2019).

clothing components are also factored out, this indicator of underlying inflation remained unchanged recently at 1.1%.

Annual consumer price inflation in October dampened by energy; core rate up

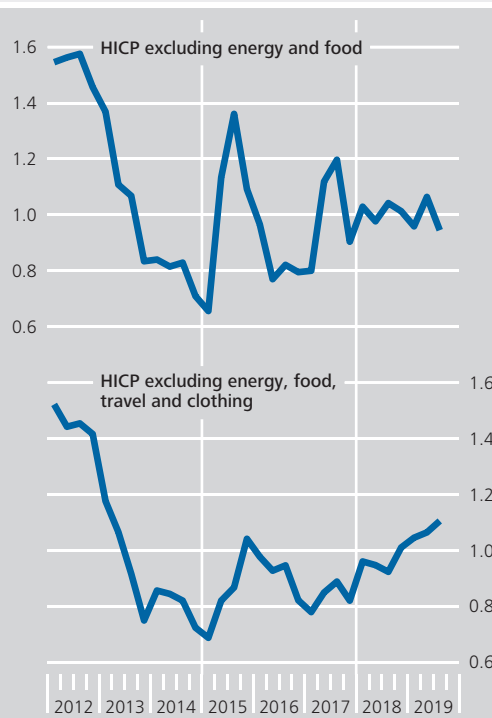
In October, consumer prices rose by a seasonally adjusted 0.1% from the preceding month. Prices for services and energy were up slightly, while food and non-energy industrial goods prices remained unchanged. The annual rate of change in HICP declined to 0.7% owing to another base effect caused by energy prices. In contrast, the rate excluding energy and food increased to 1.1%.

No improvement in cyclical outlook so far

There are very few signs that the euro area will experience any distinct acceleration in economic growth in the fourth quarter of 2019 and the first quarter of 2020. Instead, sentiment continued to deteriorate amongst enterprises and households up until October, according to the European Commission surveys. While confidence remained at its above-average level among consumers, in the manufacturing sector it was markedly below its long-term average. A similar picture emerges from the purchasing managers' index for the economy as a whole, which was only slightly above the expansion threshold. In the manufacturing sector, where the current situation and outlook are considered to be especially poor, there have nevertheless been recent signs of stabilisation. The survey results also suggest, moreover, that the economic slowdown in the industrial sector

Measures of underlying inflation in the euro area

Year-on-year percentage change, quarterly data



Sources: Eurostat and ECB.
 Deutsche Bundesbank

is increasingly spilling over to the services sector. From this perspective, the growth outlook for the last quarter of 2019 and the first quarter of 2020 remains subdued. That said, a number of political risks may diminish in the global setting and in the euro area, which could strengthen confidence again.

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