The German economy

Macroeconomic situation

German economy weighed down by pandemic, high inflation and the Russian attack on Ukraine in Q1 2022

Economic activity in Germany picked up slightly in the first quarter of 2022, after declining somewhat in the final quarter of 2021. According to the Federal Statistical Office's flash estimate, real gross domestic product (GDP) was 0.2% up on the quarter after seasonal adjustment.[1] Construction provided a strong boost, helped by the mild weather conditions. Thanks to a good start to the year, industrial output also increased somewhat on the quarter. The effects of Russia's war on Ukraine have been weighing considerably on the economy since the start of the conflict, however. Supply bottlenecks flared up again in industry and in construction, after having arguably eased somewhat at the beginning of the quarter.[2] The steep rise in energy prices, too, will have slowed output. Exports declined sharply in March and were also well below the previous quarter's level in the first quarter of 2022 as a whole. High energy prices also exacerbated the already high rate of price increase, diminishing the purchasing power of household incomes. This depressed private consumption, which was impaired further by the pandemic and the associated containment measures. By contrast, construction investment and investment in machinery and equipment are likely to have increased, despite the supply bottlenecks.

Economic output could grow slightly at most in Q2

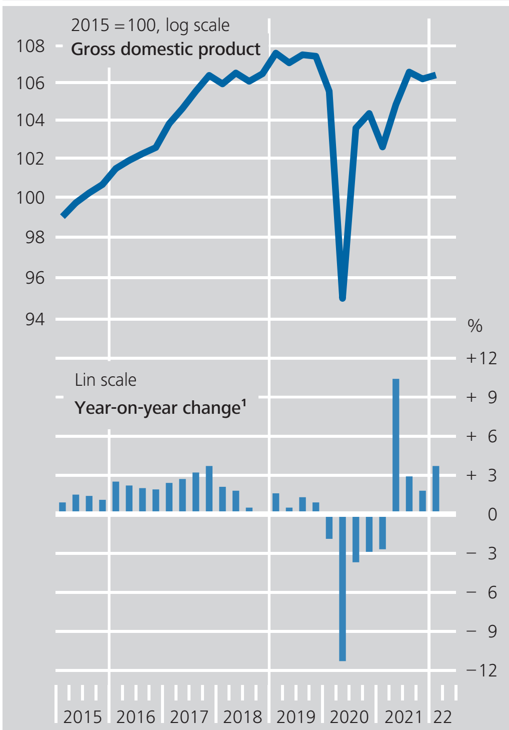
Looking ahead to the second quarter, opposing forces are likely to have an impact on economic output. Headwinds are coming, in particular, from the high level of inflation, supply bottlenecks, high uncertainty and weaker foreign demand. These are being counterbalanced by the broad and extensive easing of coronavirus mitigation measures. On balance, from today's perspective, these upward forces are likely to prevail by a slight margin at best.

Exports of goods down significantly in Q1

Exports of goods declined significantly in the first quarter of 2022 in real terms. In regional terms, this was mainly due to a steep decline in exports to euro area countries, probably partly on account of the fairly weak pace of growth in the euro area. Exports to non-euro area countries also declined slightly, however. Exports to Russia fell considerably in terms of value.[3] In March, they dropped by just over three-fifths as a result of the sanctions and other measures taken in response to Russia's invasion of Ukraine. The value of exports to the newly industrialised Asian economies also decreased in the first quarter. By contrast, nominal exports to the United Kingdom remained virtually stable. Exports to the United States,

Aggregate output

Adjusted for price, seasonal and calendar effects



Source of unadjusted figures: Federal Statistical Office. **1** Price and calendar adjusted.
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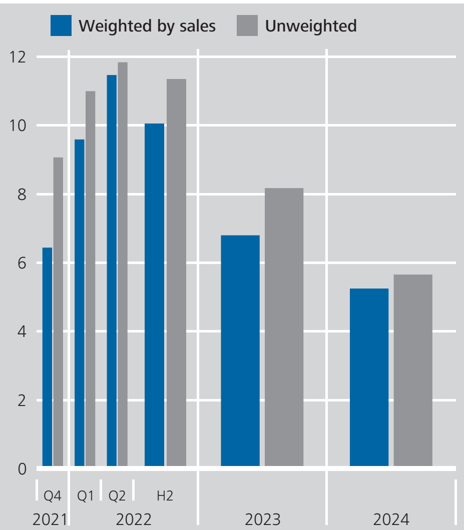
1 Seasonal adjustment here and in the remainder of this text also includes adjustment for calendar variations, provided they can be verified and quantified.
2 See the box on pp. 58 f. of this Monthly Report.
3 In 2021, the value of goods exports to Russia accounted for a little less than 2% of German foreign trade.

Supply bottlenecks likely to weigh on industrial production for quite some time

Since the beginning of 2021, there have been considerable bottlenecks in the supply of important intermediate products and raw materials. In Germany, this has primarily affected industry.[1] As a result, industrial production has not yet returned to its level prior to the coronavirus crisis, despite high demand for industrial products. These supply bottlenecks have continued to put significant strain on German industry this year. They had eased somewhat before the Russian attack on Ukraine.[2] The war, however, caused a relapse.[3] Some intermediate products are not available due to the war and sanctions. Logistical problems and high transport costs have also played a role. The resurgence of the pandemic in China and the associated stringent protection measures have further exacerbated supply problems.

(Expected) production losses stemming from supply bottlenecks*

%



Source: Bundesbank Online Panel Firms, March 2022. * Based on the responses of 404 (out of 507) manufacturing firms to the question of what percentage decline in the production of goods they had recorded or expected as a result of supply bottlenecks. No production losses were assumed for the remaining 103 industrial enterprises, which did not record or expect a deterioration in access to intermediate goods in 2021 and 2022.

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In March 2022, the Bundesbank surveyed industrial enterprises as part of the Bundesbank Online Panel Firms (BOP-F) on the current and expected impact of supply bottlenecks on their production activity.[4] Of more than 500 manufacturing enterprises surveyed, 80% reported that their access to intermediate goods had deteriorated in 2021 or that they expected it to do so in 2022. These enterprises were then asked how strong the decline in output due to supply bottlenecks had been or was likely to be.[5] This helps provide an impression not only of the breadth of the impact of supply bottlenecks across enterprises, but also of its intensity. In addition, respondents were

1 It is true that supply difficulties arose when the coronavirus pandemic started back in spring 2020. However, these bottlenecks have been weighing on the global economy since the spring of 2021 in particular, when global demand surged following the pandemic-induced lockdowns in the winter of 2020-21. The supply bottlenecks are therefore, in principle, a global phenomenon, which can be attributed to various factors on both the demand and supply sides. See Deutsche Bundesbank (2021a).
2 See ifo Institute (2022a).
3 In March and April 2022, 80% and 75% of enterprises, respectively, complained about bottlenecks in the procurement of intermediate products and raw materials. See ifo Institute (2022b). Purchasing managers also reported renewed supply chain disruptions, with both the war and pandemic protection measures in China playing a role. See BME (2022).
4 See Deutsche Bundesbank (2022a). However, the relevant questions were only asked in March 2022 (wave 14). Answers were received during the period from 26 February 2022 to 23 March 2022.
5 Six different periods were considered: the fourth quarter of 2021, the first quarter of 2022, the second quarter of 2022, the second half of 2022, and the years 2023 and 2024. The responses were also weighted by enterprise sales in 2021. No production losses were assumed for the 20% of enterprises which did not record or expect a deterioration in access to intermediate goods in 2021 and 2022. Exceptions to this simplified assumption – for example, if a company expected an improvement in access to intermediate products overall in 2022, but still feared production losses due to supply bottlenecks – would therefore imply even higher declines in production than calculated here.

asked to provide an estimate of the expected duration of the supply disruptions.[6]

The results suggest that supply bottlenecks weighed more heavily on output in the first quarter of 2022 than in the fourth quarter of 2021. This likely reflects a major decline in output in March as a result of the Russian attack on Ukraine.[7] Given the ongoing war in Ukraine, industrial enterprises expect production losses to worsen in the second quarter. According to the survey, that is when the supply chain problems will reach their peak. Expected production losses gradually decline thereafter. However, even in 2024, enterprises still expect distinct production losses due to supply bottlenecks.[8]

According to the survey results, the problems caused by supply bottlenecks will thus persist for longer than had been assumed in the Bundesbank's macroeconomic projection of December 2021. At that time, a gradual easing of supply bottlenecks by the end of 2022 was expected, with subsequent strong catch-up effects.[9] This will place a significant strain on industrial production and will cause a significant delay to the originally expected recovery. The survey results do also suggest that some catch-up effects from previously lost production could occur. For example, firms that experienced or expected a decline in production for at least one of the periods under review were asked whether they expected to be able to recover some of the production they had lost as a result of supply bottlenecks. Almost half said yes.[10] All in all, however, the survey results suggest a much more cautious view of supply bottlenecks and their consequences than the assumptions made in the December projection.

Two important factors need to be taken into account when interpreting these results. The Russian war of aggression began two days before the first industrial enterprise submitted its responses to the survey. The responses could thus be strongly influenced by the invasion and its attendant uncertainties. These relate, in particular, to the reliability of the energy supply at their production sites in Germany.[11] The expected losses in production – some even lasting into 2024 – could partly reflect concerns about energy disruptions. Nevertheless, as long as the relevant supplies from Russia do not actually fail to materialise, the survey results are likely to overstate the expected production losses. This stands in contrast, however, to the pandemic situation in China, at least in the short term. The latest lockdown in Shanghai began at the end of March, and thus after the survey was completed. Production losses could therefore have been underestimated, especially in 2022.

6 At the end of 2021, the German Economic Institute (*Institut der deutschen Wirtschaft,* IW) and the ifo Institute already carried out a survey on expected production shortfalls due to supply bottlenecks and their duration. In the IW economic survey in autumn 2021, three-quarters of the enterprises surveyed reported a loss in output of, on average, 7% for the fourth quarter of 2021. Moreover, enterprises said that they expected that the situation would only start to improve significantly from the second half of 2022 onwards. See German Economic Institute (2021). This is consistent with the results of the ifo Institute survey of November 2021, which show that industrial enterprises assumed, on average, that supply problems would last eight months, i.e. until mid-2022. See ifo Institute (2021).
7 According to the German Association of the Automotive Industry, for example, fewer cable harnesses were supplied for the manufacture of motor vehicles. Besides Tunisia, their main country of manufacture is Ukraine. Owing to their specific nature, production of these items could not be moved or substituted on short notice. See German Association of the Automotive Industry (2022).
8 A comparison of the weighted and unweighted results shows that larger enterprises consistently expect somewhat smaller production losses.
9 See Deutsche Bundesbank (2021b).
10 These enterprises were then asked how long they expected the catch-up process would last. More than 60% of them expected a period lasting until the end of the current year. Almost all remaining enterprises expected a period lasting until the end of 2023.
11 The economic consequences of a cut in Russian gas supplies were already being discussed prior to 24 February 2022. From the moment Russia first publicly threatened to halt supply on 7 March 2022, at the very latest, the issue became omnipresent.

China and Japan even increased significantly. Broken down by category of goods, price-adjusted exports of intermediate goods and capital goods declined sharply, whilst exports of consumer goods picked up distinctly.

Probable increase in business investment in machinery and equipment

Until the start of the war, business investment in machinery and equipment is likely to have been supported by positive expectations about future output and by the easing of supply bottlenecks in the meantime. However, the outlook deteriorated considerably from March onwards, and uncertainty surrounding the continuation of the conflict is likely to have weighed on the propensity to invest. Nevertheless, business investment may have risen overall in the first quarter. The strong increase in the domestic sales of manufacturers of capital goods would suggest that this is the case. While this stood against a steep decline in the value of imports of capital goods, enterprises probably invested somewhat more in their vehicle fleets. This is indicated by the number of new commercial registrations of passenger vehicles, which rose slightly according to the German Association of the Automotive Industry (VDA). There was also a significant increase in the number of commercial vehicle registrations.

Construction investment probably up substantially

Construction investment probably increased substantially in the first quarter, as suggested by sales in the main construction sector – figures for which are available up to February – which were up considerably from the fourth quarter in terms of value. Even if the sharp rise in construction prices is taken into account, significant growth is still likely. Investment in public construction looks to have increased particularly strongly.

Pandemic and high inflation weighing on private consumption

Private consumption is likely to have declined in the first quarter of 2022. On the one hand, it was constrained by pandemic-related restrictions, which particularly affected the consumption of contact-intensive services. For example, first-quarter revenue in the hotel and restaurant services sector was significantly lower than in the fourth quarter. In addition, high inflation reduced households' purchasing power. Uncertainty about the consequences of the war also weighed on the propensity to consume, especially at the end of the quarter. In the retail sector, price-adjusted sales declined somewhat. As in previous waves of the pandemic, sales figures fell especially steeply for bricks-and-mortar outlets selling textiles, clothing, footwear and leather goods, as well as for retailers of information and communication technology devices. However, retail sales via mail order and the internet, which were not affected by the protective measures, also fell sharply. In addition, there were probably fewer cars purchased. This is indicated by new car registrations for private owners, which declined markedly in the first quarter, according to VDA data.

Price-adjusted imports of goods down significantly

Price-adjusted imports of goods posted a significant decline in the first quarter of 2022. From a regional perspective, the decline stemmed from trade with euro area countries, as was the case for exports. Imports from non-euro area countries were slightly higher, however, with the value of imports from OPEC countries and Russia increasing sharply. This was due to the high share of energy imports and the inflation in their prices. Nominal imports from China also rose strongly. Price-adjusted imports of capital goods declined steeply, whilst imports of intermediate goods were down slightly. Imports of consumer goods increased somewhat.

Sectoral trends

Recovery in industrial production slowed down, particularly by effects of war on Ukraine

Seasonally adjusted industrial production in the first quarter of 2022 increased slightly on the quarter (+½%). In January and February, it had initially recovered further. In March, however, it declined considerably as the war against Ukraine created many burdens, including new disruptions to supply chains. According to surveys by the ifo Institute, the percentage of enterprises reporting production delays caused by supply bottlenecks rose sharply again. While capital goods were still a driver of growth in the fourth quarter of 2021, their output dropped markedly in the first quarter of 2022. This was partly due to the fact that motor vehicle production, which is important for the German economy, was probably severely affected by the renewed tightening of supply bottlenecks. By contrast, manufacturers of other transport equipment and of computer, electronic and optical products saw a major increase in production. Industrial production was bolstered by a robust increase in the manufacture of consumer goods. In particular, the manufacture of pharmaceutical products increased considerably. Production of intermediate goods edged up slightly.

Utilisation of industrial capacity stable at above average level

According to the ifo Institute, capacity utilisation of tangible fixed assets in manufacturing remained constant between the surveys in January and April. It thus continued to distinctly exceed its long-term average. Capacity utilisation in capital goods manufacturing fell sharply, which is consistent with the lower output of capital goods. Although considerably more consumer goods were produced, capacity utilisation among their manufacturers remained unchanged. By contrast, capacity utilisation rose slightly for manufacturers of intermediate goods.

Construction output up sharply, particularly owing to favourable weather conditions

Construction output picked up strongly in seasonally adjusted terms in the first quarter of 2022 (+4%), growing substantially on the quarter in both the finishing trades and main construction sector. The increase in output in the main construction sector was spread equally across building construction and civil engineering. The main reason for the higher level of construction output was the mild weather for the time of year. According to ifo Institute surveys, the share of enterprises reporting materials shortages initially declined, much like in the industrial sector, but rose again significantly in March due to the war against Ukraine. In line with the sharp expansion in construction output, the utilisation of machinery and equipment increased significantly in the reporting period and remained high in a long-term comparison.

Foreign trade

Seasonally and calendar adjusted, quarterly data

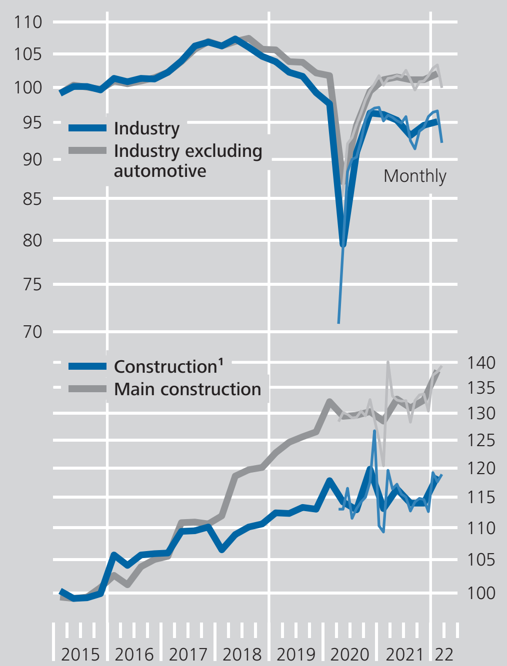
Source of unadjusted figures: Federal Statistical Office. **1** Adjusted using the price indices for foreign trade.
Deutsche Bundesbank

Activity in services sector probably declining

Activity in the services sector is likely to have declined in the first quarter. In the hotel and restaurant services sector, price-adjusted sales fell significantly on average in the first quarter compared with the previous quarter. However, they picked up again over the course of the quarter. In the reporting period, there were entry restrictions in place for hotels and restaurants, which have since been eased again. The coronavirus protection measures hit revenue in the accommodation sector much more strongly than they did food and beverage ser-

Output in industry and in construction

2015 = 100, seasonally and calendar adjusted, quarterly data, log scale



Source of unadjusted figures: Federal Statistical Office. **1** Main construction sector and finishing trades.
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vices. Real sales in the retail sector declined markedly. Wholesale sales fell slightly, according to the data available up to February. Sales of motor vehicles were probably also down. On an average of January and February – data are available up until then – price-adjusted sales in the motor vehicle trade remained unchanged compared with the fourth quarter of 2021. However, the number of car registrations recorded by the VDA dropped dramatically in March and were slightly below the previous quarter's level in the first quarter. The results of ifo Institute surveys on the business situation of enterprises also signal a decline in business activity in the services sector in the first quarter of 2022.

Labour market

The labour market developed exceptionally favourably in the first quarter of 2022. Employment expanded strongly and unemployment continued to decline markedly. Both indicators returned to the levels seen just before the outbreak of the pandemic. However, this also saw the return of the labour shortages seen before the crisis. The factors weighing on economic activity in the first quarter – the strong spread of the Omicron variant and, most recently, Russia's invasion of Ukraine – are more likely to have had an adverse impact on actual hours worked by employees and labour productivity. Cyclical short-time work increased again somewhat, for instance. Nevertheless, the leading labour market indicators remained optimistic for the coming months after having been briefly shaken by the outbreak of war.

Employment and unemployment barely touched by strains on the economy

The number of employed persons rose sharply in the first few months of 2022. On an average of the first quarter, the seasonally adjusted number of persons in work rose by 217,000 on the quarter overall, representing an increase of 0.5%. In March, the previous peak in employment recorded in early 2020 was exceeded for the first time. The increase in employment is predominantly attributable to jobs subject to social security contributions. On an average of January and February alone – estimates do not yet go beyond that – 200,000 more persons were employed in jobs with full social security coverage than in the final quarter of 2021. There was robust employment growth in almost all economic sectors. The strongest increase was recorded in IT and in administrative and support services (including temporary employment). Some services sectors benefited from reduced containment measures to combat the pandemic over the course of the quarter. After a long period of stagnation, employment growth in the manufacturing sector also started to pick up a little. However, the strains entailed by the international setting are having the most noticeable dampening effect on employment growth in this sector.

Employment up sharply in Q1, in a return to pre-crisis levels

Unlike employment, cyclical short-time work has not yet returned to its pre-crisis level. According to estimates by the Federal Employment Agency, the number of short-time work-

Marked rise in short-time work over December and January ers increased slightly in December and January compared with November 2021. Since the average working hours lost per short-time worker were also markedly higher, the total loss of working hours rose by more than one-third in these two months. Once again, because of the pandemic, this mainly affected the hotel and restaurant services sector and, to a lesser extent, the wholesale and retail trade. However, the number of short-time workers fell again in February. This decline may have continued in the subsequent months as well, seeing as registrations for short-time work dropped significantly in March and April.

Unemployment also back to pre-crisis levels

Unemployment was distinctly down in the first quarter of 2022. In seasonally adjusted terms, the Federal Employment Agency registered just over 100,000 fewer unemployed persons than in the fourth quarter of 2021, with the corresponding rate falling by 0.2 percentage point. In April 2022, the number of unemployed persons continued to decline, dropping to 2.29 million, and the unemployment rate to 5.0%. This matches the level of the first quarter of 2020, which had not yet been affected by the pandemic. The number of unemployed persons covered by the statutory unemployment insurance scheme who can be placed relatively quickly is already lower than immediately prior to the outbreak of the pandemic, and has barely fallen in recent months. By contrast, the reduction in unemployment among those receiving the basic welfare allowance accelerated.

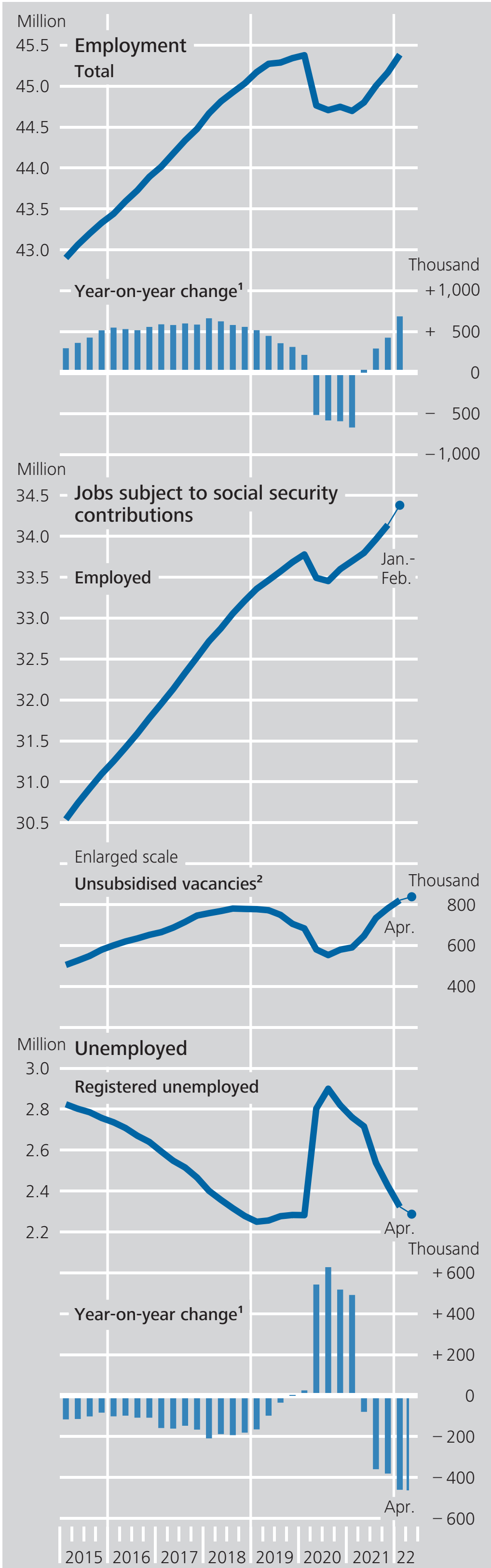
Hours worked per employee and hourly productivity not yet fully recovered, however

In contrast to employment and unemployment, other labour market indicators, such as hours worked per employee, have probably not yet returned to their pre-crisis levels.[4] Over the past two years, adjustment to the fluctuating level of output during the various waves of the pandemic has largely been through working hours. In addition to the massive use of short-time

4 Hours worked and labour productivity are components of the national accounts, which were not yet available for the first quarter of 2022 as at the cut-off date for this report.

Labour market

Seasonally adjusted, quarterly data



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

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work, the number of hours worked has also been shortened due to fewer overtime hours worked and the reduction of balances on working time accounts. Even if the long-term negative trend in hours worked – which is mainly due to the increasing share of part-time work – is taken into account, the number of hours worked is still significantly lower than would be expected if the crisis were fully overcome. In the reporting quarter, the spread of the Omicron wave is likely to have additionally reduced hours worked, as employees were sick or in quarantine. The outbreak of war in Ukraine and pandemic-related closures in China are placing further strain on economic activity. Labour productivity, which has also remained below its trend level so far, will continue to suffer as a result.

Employment plans still expansionary despite burdens

The leading labour market indicators, which focus mainly on further employment developments, remained very stable in expansionary territory despite the added uncertainty and foreseeable burdens caused by the Ukraine war. According to the employment barometers of the ifo Institute and the Institute for Employment Research (IAB), enterprises are planning to increase their staff numbers on balance. With infection rates on the decline, the outlook has improved, especially in some services sectors. In the manufacturing sector, by contrast, recruitment plans are less expansionary. Despite recent events, the number of reported vacancies subject to social security contributions has risen again. The ongoing shortage of qualified staff is also likely to have played a part in this. The time taken to fill vacancies is already very long and continues to rise. Unemployment is expected to decline further over the next few months, too, according to the IAB's survey of the heads of regional employment agencies.

Wages and prices

Negotiated wages rose considerably more strongly in the first quarter of 2022 than in the final quarter of 2021. In the first quarter, they increased by 4.4% on the year, compared with 1.6% in the preceding quarter. This high growth rate was largely attributable to sizeable one-off payments in industry and large coronavirus bonuses, granted in the public sector of the Federal states, in particular. Meanwhile, basic pay adjusted for such one-off payments rose by just 1.6% in the first quarter year-on-year, after 1.8% in the fourth quarter of 2021. Actual earnings are likely to have risen even more sharply than negotiated wages in the first three months of the year. This is mainly because noticeably less short-time work meant that the number of hours worked was significantly higher than in the first quarter of 2021.

Negotiated wages rose considerably in Q1 due to high one-off payments; actual earnings probably also rose substantially

Wage agreements still moderate so far, …

At present, the growth in negotiated wages is still being driven by old collective agreements, which were concluded in an environment of lower inflation rates and pandemic-related challenges. New agreements made in the first quarter were, likewise, usually still moderate despite the sharp rise in inflation. For example, the annualised wage growth in the latest wage agreements for private and public sector banks, the printing industry and insurance companies ranged from 1.6% to 2.4%. In the chemical industry, management and the trade unions agreed on a large one-off payment and for the agreement to have only a short term until the autumn of 2022 as a "bridging solution". The main reason for this was the uncertain economic outlook due to the war in Ukraine and the considerable rise in energy prices.

… however, wage agreements could be markedly stronger over the coming months

On the one hand, uncertainty about future economic developments and concerns about potential job losses could dampen wage increases somewhat in the upcoming wage negotiations. On the other hand, persistently high inflation rates and increasing labour market tightness are likely to contribute to noticeably more substantial wage settlements than in the recent past. For example, the trade unions' minimum aim is to compensate for the high inflation rates. In the steel industry, the IG Metall trade union is demanding a wage increase of 8.2% to apply for a 12-month period. The current wage demands being made by trade unions in other sectors range from 6% to 7.5% to run for 12 months. It remains to be seen whether these demands are achieved. It should be borne in mind that higher prices for largely imported fossil fuels narrow the scope for income distribution within Germany.

Inflation significantly higher in Q1

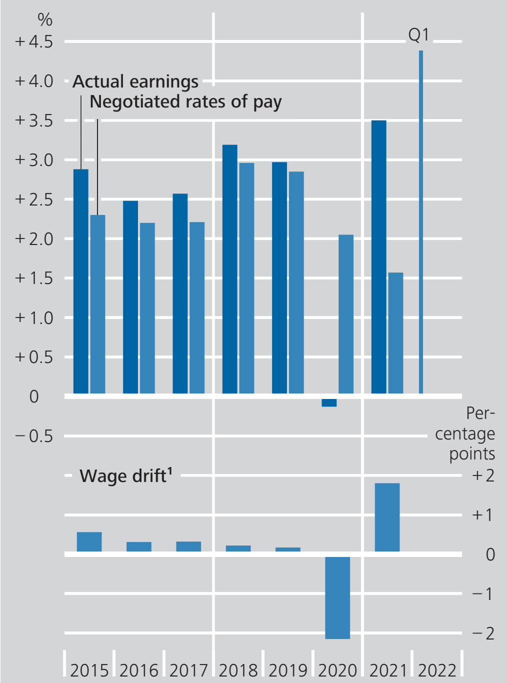
Consumer prices spiked sharply higher again at the beginning of the year. In the first quarter of 2022, quarterly inflation as measured by the Harmonised Index of Consumer Prices (HICP) stood at 2.8% after seasonal adjustment, up from 1.2%. This was the strongest quarterly increase in prices in Germany since the beginning of monetary union. The momentum of energy price growth was particularly high given the dramatic rise in crude oil prices and market prices for not only gas but also electricity. Moreover, new supply bottlenecks caused a considerable acceleration in the rate of price increase for food and non-energy industrial goods. This was partly due to the impact of Russia's war against Ukraine, which likewise contributed to the sharp rise in energy prices. In terms of services, the price increase remained above average, but not quite as much so as in the previous quarters. Looking at the annual figures, too, the inflation rate rose significantly in the first quarter of 2022, from 5.4% to 6.1%. Factoring out the volatile components energy and food, however, the inflation rate fell distinctly, from 3.6% to 3.1%. However, this was mainly attributable to the end of the base effect as a result of the temporary VAT cut in the second half of 2020, which had lifted inflation in the final quarter of 2021.

Broad-based price surge again in April

In April, seasonally adjusted prices rose considerably on the month, although the increase was not as exceptionally strong as in March. This was chiefly attributable to energy prices, which fell slightly following a sharp rise in the previous month. By contrast, food prices rose even more steeply than they did when the temporary VAT cut was reversed in January of last year. There was a significant increase in the cost of meat, as well as cereals and dairy products, in particular. Prices of non-energy industrial goods and services also rose on a broad basis. Compared with the previous year, prices grew by a total of 7.8%, compared with already 7.6% in March.[5] The last time such high rates were observed in the former West Germany was during the first Gulf War at the beginning of the 1980s. Excluding energy and food, the rate of price increase worked out at 3.9%, up from 3.4%.

Rates of pay and wage drift

Year-on-year change, on monthly basis



Sources: Federal Statistical Office (actual earnings) and Deutsche Bundesbank (negotiated rates of pay). **1** Wage drift is calculated as the annual change in the ratio of actual earnings to negotiated rates of pay.
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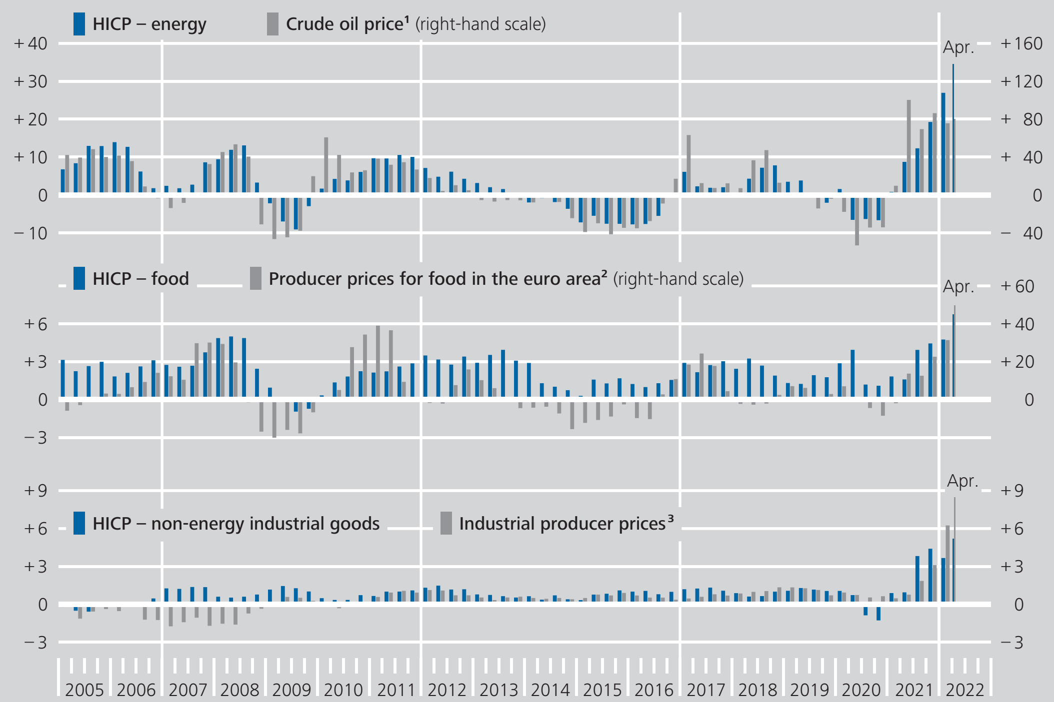
Inflation likely to remain high for the time being

Over the coming months, consumer price inflation could initially continue to rise slightly and then decline only moderately given the high rates of price increase at earlier stages of the pricing chain. In view of the war in Ukraine and supply bottlenecks resulting from the pandemic, producer prices for consumer goods (excluding food) rose sharply by historical standards in the period under review. Much the

5 The national consumer price index rose at a rate of 7.4%, up from 7.3%.

Price developments at economic stages as classified for HICP purposes

Year-on-year percentage change



1 Bundesbank calculations (in euro) based on daily prices in USD as quoted by Bloomberg Finance L.P. **2** ECB calculations of DG AGRI prices based on the European Commission's farm gate and wholesale prices. **3** Analogous to HICP classification "non-energy industrial goods"; Bundesbank calculations based on data from the Federal Statistical Office.

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same is true of producer prices for food. This is likely to make industrial goods and food more expensive at the consumer level. In the services segment, too, enterprises have recently signalled an increasing willingness to pass through to consumer prices the higher cost of intermediate goods and the increase in the minimum wage due to be introduced in October 2022.[6] This option is made easier by ongoing high demand. Government relief measures relating to fuel, electricity and local public transport are likely to temporarily dampen the price increases somewhat. Overall, though, as things currently stand, the inflation rate is still likely to average around 7% this year. That said, uncertainty about the price outlook is particularly high at present.

Order books and outlook

Economic output likely to increase slightly in Q2, if at all; positive effect of easing of measures to contain the coronavirus probably offset by impact of war in Ukraine

As things currently stand, German economic output is likely to increase slightly, if at all, in the second quarter of 2022.[7] This is due to the interplay of strong but opposing forces. On the one hand, the easing of the measures designed to contain the coronavirus is likely to provide a major boost to services and the related consumer spending. On the other hand, the repercussions of Russia's attack on Ukraine are exacerbating the pressures exerted by high inflation and supply bottlenecks. They are also giving rise to further negative effects and will probably considerably weaken the strong recovery that had previously been anticipated. Household consumption is being dampened by the high level of inflation and by the uncertainty about how the conflict will evolve. High energy and materials costs and the heightened uncertainty are also weighing on output in the industrial sector and in construction. Supply

6 See Deutsche Bundesbank (2022b).
7 However, the outlook is highly uncertain and depends on further developments in the war on Ukraine. For more information on the possible macroeconomic effects in a severe crisis scenario, see Deutsche Bundesbank (2022c).

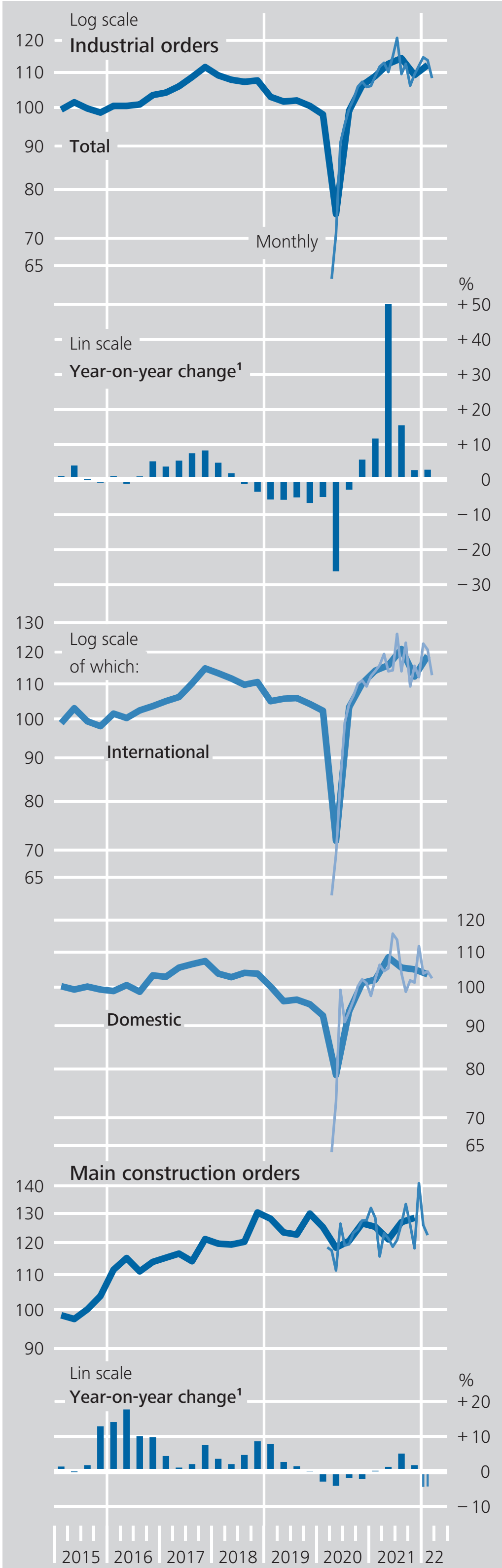
chains are once again coming under significant strain on account of the war in Ukraine and coronavirus lockdowns in China. According to Bundesbank survey results, this is likely to lead to an increase in output losses in manufacturing (see the box on pp. 58 f.). This is consistent with VDA data on the number of passenger cars manufactured, which recovered only partially in April from the sharp downturn in March and were still markedly lower than in the first quarter. Exports are also likely to remain markedly below the level of the first quarter due to the disruptions to foreign trade and lower foreign demand as a result of the impact of the war. This is suggested, amongst other things, by the sharp decline in export expectations in manufacturing, but also by the drop in China's imports in April.

High inflation and uncertainty are holding back the recovery in private consumption

Households' consumption expenditure could pick up significantly again in the second quarter. The broad and extensive easing of the measures taken to contain the coronavirus means that many of the consumption options that were previously restricted are available once more and are probably also being used. According to ifo Institute surveys, for example, the assessment of the current situation of firms in the hotel and restaurant services sector brightened considerably in April. Moreover, footfall figures, which are available up to mid-May, were considerably higher than in the first quarter. However, high inflation, the associated loss of purchasing power and the increased uncertainty surrounding the war on Ukraine are likely to represent a considerable drag on the recovery in private consumption. At last count, income expectations as measured by the market research institution Gesellschaft für Konsumforschung (GfK) fell to their lowest level in almost 20 years. Economic expectations and the propensity to purchase also declined considerably. The forecast consumer climate index fell to a historical low. Retail trade, in particular, could suffer from consumers' reluctance to consume. According to surveys conducted by the ifo Institute, business conditions there de-

Demand for industrial goods and construction services

Volumes, 2015 = 100, seasonally and calendar adjusted, quarterly data



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

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teriorated sharply during the period under review.

Sentiment among firms considerably worse than in Q1

The ifo business climate index recovered only marginally in April from the sharp downturn it suffered in March. This meant that sentiment remained considerably below the average of the first quarter. One of the main reasons for this was that firms' business expectations became much more pessimistic across all sectors. By contrast, firms believed their current business situation to be only slightly worse. This discrepancy can probably be explained by the fact that the very broad-based rise in concerns among some firms seen since March is not yet reflected in actual business activity. There are major differences between the sectors, however. Sentiment in the main construction sector and – to a somewhat lesser degree – in the manufacturing sector deteriorated particularly sharply, both in terms of expectations and the assessment of the current situation. A significant further increase in materials shortages has been a factor in both sectors since the outbreak of the war. Production plans in manufacturing fell sharply. By contrast, the situation among retailers deteriorated only somewhat. Elsewhere in the services sector, the assessment of the current situation actually improved. The easing of the measures intended to contain the coronavirus was probably a major factor in this.

Orders situation in industry still good

Industrial new orders rose significantly in the first quarter of 2022 compared with the previous quarter. This was due, in particular, to large orders; if these are excluded, new orders increased only slightly. Broken down by region, the inflow of new orders from non-euro area countries rose substantially. By contrast, slightly fewer new orders were received from the euro area countries and from within Germany. Broken down by sector, demand for capital goods rose sharply. In particular, new orders in the manufacture of other transport equipment, which are usually very volatile, climbed steeply. Manufacturers of machinery and equipment, meanwhile, received distinctly fewer orders. Demand for consumer goods expanded strongly. Manufacturers of pharmaceutical products also saw a sharp rise in new orders. By contrast, the inflow of orders to intermediate goods producers declined slightly. According to data provided by the Federal Statistical Office, the order books and the reach of the order books continued to increase from already high levels. The results of ifo Institute surveys suggest that the orders situation in manufacturing remained good in April.

Construction sector suffering from, amongst other things, materials shortages and higher interest rates for building finance

In the construction sector, output could decline in the second quarter. The mood among firms in the main construction sector suffered from the recent significant increase in materials shortages and a renewed worsening of labour shortages. The high cost of construction materials and higher interest rates on loans for building finance are placing an additional burden on the construction sector.[8] According to ifo Institute surveys, business expectations even fell to their lowest level since German reunification. In addition, the first quarter benefited from mild weather, which means that a countermovement is likely in the second quarter. As previously, the demand side is unlikely to be the limiting factor for construction. According to the data available up to February, new orders in the main construction sector declined sharply. However, surveys conducted by the ifo Institute show the reach of the order books to have remained exceptionally high in April.

8 See ifo Institute (2022c).

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