The German economy

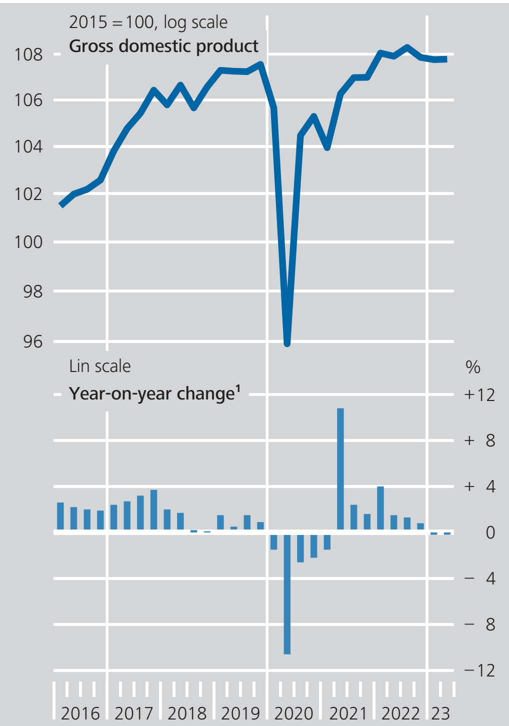
Macroeconomic situation

German economy still experiencing weak spell

The German economy is still experiencing a period of weakness. Economic output stagnated in the second quarter of 2023, after having contracted in the winter half-year (October-March). According to the Federal Statistical Office's flash estimate, gross domestic product (GDP) remained at the level recorded in the previous quarter in seasonally adjusted terms.[1] Weak foreign demand weighed on industry. Higher financing costs also presented headwinds for the economy. These depressed demand for construction work and capital goods. Developments in the economy could have been even weaker were it not for the still high backlog of orders in parts of industry and construction and abating supply bottlenecks. The sound labour market also acted as a tailwind for the economy. As wages continued to rise steeply and inflation was no longer quite so high, it is likely that private consumption recovered somewhat.

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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Economic activity in detail

Industry and exports of goods lacklustre

After seasonal adjustment, industrial output declined markedly in the second quarter. This is likely to have been reflected in the trend decline in domestic and foreign demand.[2] In addition, high energy costs are likely to have weighed heavily on some industrial sectors. Output in the energy-intensive sectors fell steeply as a result. This is reflected in the marked drop in the manufacture of intermediate goods, which encompasses the energy-intensive industrial sectors. Non-energy-intensive sectors were likewise affected by the decline, however. Production of capital goods was also lower, for example. Higher financing costs, which are weighing on demand, are likely to have played a major role in this. By contrast, production of consumer goods expanded. According to surveys by the ifo Institute and S&P Global, supply bottlenecks in industry continued to ease overall. Together with the large order backlog, this offset the decline in demand. Weak foreign demand was reflected in slightly lower price-adjusted goods exports.

The rise in financing costs dampened demand for commercial investment in machinery and equipment while on the other hand the easing of supply bottlenecks benefited investment. Price-adjusted imports of capital goods point to

1 Seasonal adjustment here and in the remainder of this text also includes adjustment for calendar variations, provided they can be verified and quantified. The flash estimate also included revisions for the previous quarters in some cases. Overall, this results in a markedly higher level of economic activity than previously reported.
2 Industrial orders increased overall in the second quarter but excluding large orders they continued to decline sharply.

Commercial investment in machinery and equipment caught between higher financing costs and diminishing supply bottlenecks

an increase in investment although capital goods producers experienced a decline in price-adjusted sales in Germany. Enterprises probably invested more in computers, electronic and optical products and in their vehicle fleets. The latter is also indicated by the sharp rise in commercial motor vehicle registrations shown in data provided by the German Association of the Automotive industry (VDA).

Construction output and investment relatively robust in view of declining demand

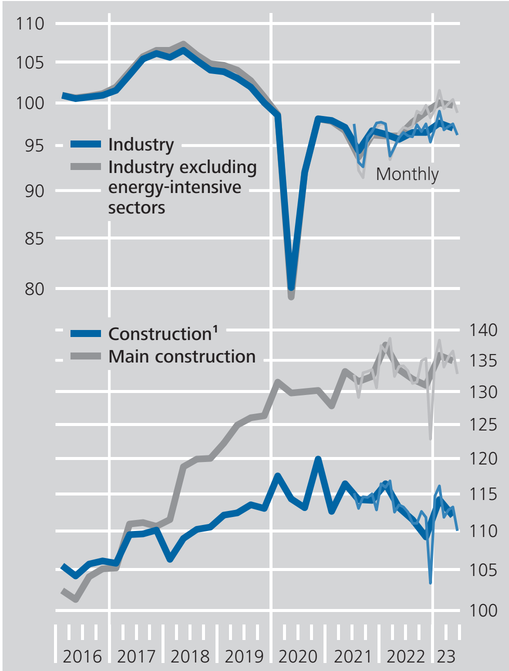
Seasonally adjusted construction output fell markedly in the second quarter, with the decline in the finishing trades significantly stronger than in main construction. A countermovement had been expected owing to favourable weather conditions in the first quarter. Demand for construction work was likewise weak. New orders in the main construction sector rose on average in April and May – data are available up to this point – compared with the previous quarter, but were considerably depressed when making a year-on-year comparison. Given this, construction output remained relatively robust. Much like in the industrial sector, diminishing material shortages and the large order backlog are likely to have provided support. According to ifo Institute surveys, the reach of order books in the main construction sector remained high in a long-term comparison, despite the decline in the second quarter. In line with output, construction investment is also likely to have remained sluggish.

Private consumption likely to have recovered somewhat and services sector activity may have increased slightly

Private consumption may have recovered somewhat in the second quarter. Inflation, which remained high despite having fallen, continued to weigh on consumers' purchasing power but this was countered by substantial wage increases. In the retail sector, price-adjusted sales went up perceptibly. Current account statistics on travel indicate that travel expenditure was significantly higher, too. Price-adjusted sales declined in hospitality services, however. Households also continued to show restraint in their car purchases. According to VDA data, new passenger car registrations fell again. The services sector as a whole may have recorded slight growth in the second quarter.

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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According to data available up to May, services production (excluding trade) even rose sharply. Motor vehicle registrations were also up noticeably overall in the second quarter on the back of commercial vehicle registrations. This should have bolstered motor vehicle trade. However, wholesale trade, which is more closely related to developments in industry, decelerated, with price-adjusted sales declining significantly.

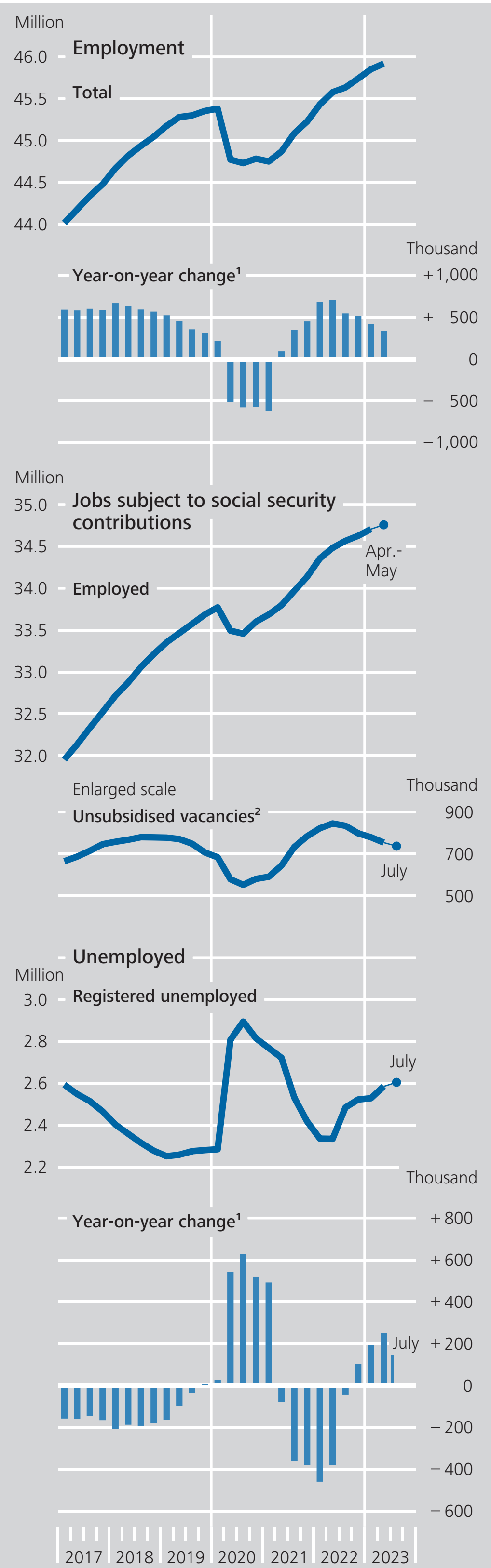
Labour market

Labour market fairly robust

The labour market is proving fairly robust in the current phase of cyclical weakness. Nevertheless, in the second quarter, the previously high pace of employment growth declined markedly, and unemployment saw a moderate uptick. Although labour market tightness eased slightly, there are still a comparatively large number of vacancies given the relatively low unemployment figures. The leading indicators

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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suggest that employment will remain stable in the coming months, with unemployment continuing to rise slightly.

Declining momentum, but stable employment

The declining momentum in the second quarter primarily marks a provisional end to what was unusually strong employment growth in the past winter half-year, given that economic activity was already weak.[3] Employment growth was still shaped by catch-up effects after the end of the pandemic, the extremely high level of labour market tightness and the very low number of working hours per employed person.[4] On an average of the reporting quarter, seasonally adjusted total employment was up by 70,000 people, or just under 0.2%, from the previous quarter's level. However, over the course of the second quarter, growth in total employment slowed considerably, coming to a standstill in June. This is mainly attributable to employment subject to social security contributions, which in April and May only slightly exceeded the level of March. The number of people in exclusively low-paid part-time work (mini-jobs) also climbed at a slower pace. However, the number of self-employed persons, which had previously been characterised by a long-term negative trend, has recently stabilised.

Employment subject to social security contributions grew mainly in certain services sectors

In the first two months of the second quarter, employment subject to social security contributions slightly exceeded the average of the first quarter of 2023 by 38,000 persons or 0.1%. Growth was particularly evident in health and social services, which are unaffected by the economic cycle, and in the public sector. Following the end of the pandemic, hospitality services once again saw positive catch-up effects, which have now expired. Employment in the manufacturing sector remained stable al-

3 As part of the revision of the national accounts, employment was revised upwards by a total of around 250,000 employees in August 2023 for the period from the beginning of 2022. This was also a significant factor in the 2022-23 winter half-year.
4 The slowdown in employment growth had already been expected in the Bundesbank's projections published in June 2023. See Deutsche Bundesbank (2023a).

though the number of temporary workers fell significantly. These are often deployed in the manufacturing sector, where they offer a flexible adjustment reserve. Employment in the wholesale and retail trade also declined.

Marked rise in unemployment in Q2

Registered unemployment rose markedly in the second quarter. Looking at the quarterly average, the Federal Employment Agency recorded just under 60,000 more persons as unemployed compared with the previous quarter in seasonally adjusted terms. The unemployment rate went up by 0.1 percentage point on the quarter, from 5.5% to 5.6%.

Over past 12 months, rise in unemployment driven roughly equally by cyclical factors and refugee migration

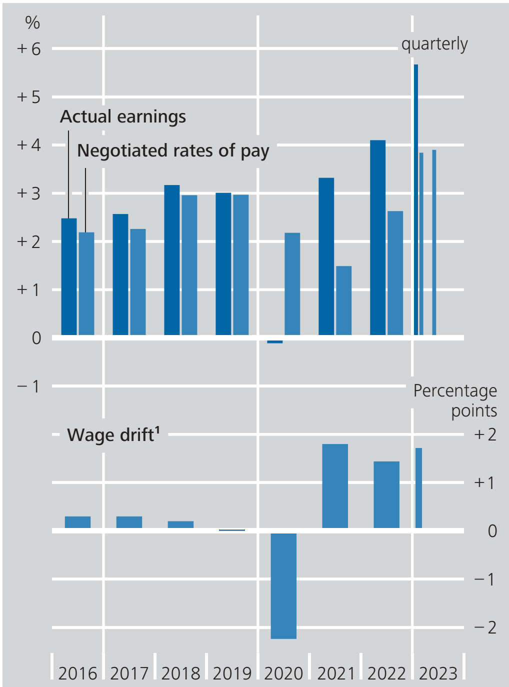
Unemployment increased somewhat on the year but this was only partly attributable to cyclical factors. The cyclical weakness is mainly reflected in the increase in unemployment among those receiving insurance benefits under the statutory unemployment insurance scheme, which has risen moderately over the past 12 months by around 75,000 persons in total. The rise in unemployment among those receiving the basic welfare allowance (SGB II) explains the second half of the increase compared to the same month one year earlier. As the first wave of Ukrainian refugees was already registered by the Federal Employment Agency one year ago after the war broke out in February 2022, the year-on-year comparison of unemployment figures is now less strongly affected by their initial registration. Nevertheless, the continued high level of immigration – not just from Ukraine – plays a role in the rise in unemployment. Registration as unemployed is part of the integration process and is therefore not an immediate warning sign for the economy.[5] As refugees generally do not have any assets and have not been insured beforehand in the unemployment insurance scheme, they are almost exclusively eligible for the basic welfare allowance (SGB II).

Leading indicators point to employment remaining stable

Leading indicators suggest that employment will remain stable in the coming months. Structural demand for labour is still high. Across the industrial sector as a whole, the private sector's hiring plans for the next three months are broadly balanced between those planning to increase their staffing levels and those with plans to reduce headcount. Service providers, for example, are expected to recruit new staff on balance. According to the monthly ifo survey, all other sectors are tending to get by with fewer staff. Although component B (employment) of the labour market barometer of the Institute for Employment Research (IAB) declined in recent months, it remains in positive territory.[6] Reported unsubsidised vacancies for positions subject to social security contribu-

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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5 Language and integration courses and labour market policy measures also form part of the integration process, however. In these cases, participants are not counted as unemployed as they are not available on the labour market. As employment is often not taken up immediately after the end of the training measure, a new period of unemployment begins. This means that the effect of refugees on the unemployment statistics can be spread over a longer time frame.

6 Here, managers from all local employment agencies are asked about the outlook in the respective agency district over the next three months.

The role of inflation and inflation expectations in wage negotiations during the period of high inflation

Growth in negotiated wages plays a key role in wage developments in Germany. Alongside productivity gains and the sector-specific labour market and business situation, inflation and expectations about inflation developments also affect the wage setting. The exceptionally high inflation rates since 2022 have highlighted the role inflation and inflation expectations play in wage negotiations from a monetary policy perspective, too. To better assess the role of these two variables in the most recent round of wage negotiations, in the summer of 2022, the Bundesbank conducted a telephone survey of experts among the wage bargainers involved in the negotiations,[1] thus quickly gaining insights into how their behaviour might have changed in the new high-inflation environment.

The survey covers the wage rounds that took place between March 2022 and May 2023.[2] The evaluation is broken down into two categories: the wage rounds in the spring and summer of 2022 and those in late 2022 and early 2023, although the latter continued into the spring of 2023 in a few cases. This breakdown allows us to identify changes in the role of inflation and inflation expectations during the period of rising inflation rates.

According to the survey, actual inflation, or rather even more so expected inflation, has played a key role for both employers and trade unions in the wage rounds since the spring of 2022. Wage bargainers relied heavily on external forecasts when forming their expectations about future inflation. The percentage of respondents using inflation forecasts produced by external providers rose markedly to 100% between the wage rounds in the spring and summer of 2022 and the winter pay rounds in late 2022 and early 2023.[3] Compared with a similar Bundesbank telephone survey conducted during the spell of low inflation in 2016, the share of trade unions that took external inflation forecasts into account in wage negotiations thus almost doubled. In the summer of 2022, economic developments were exceptionally uncertain owing to the energy crisis. In these circumstances, referring to external inflation forecasts was probably a way for the parties to strengthen their own negotiating position, with both trade unions and employers' associations relying primarily on the joint projections produced by several of Germany's institutes for economic research (the Joint Economic Forecast). However, forecasts from other bodies such as the German Council of Economic Experts were also used on occasion. These forecasts generally cover the current and next calendar year.

The Eurosystem's medium-term inflation target of 2% became significantly less relevant as an anchor in the wage negotiations over the course of 2022. This is especially true with regard to trade unions' wage demands. While two-thirds of all respondents still described the Eurosystem's inflation tar-

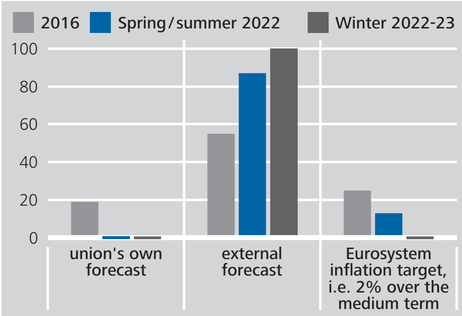
1 The 29 respondents were chief negotiators, individuals involved in the negotiations and economists from industry and trade union sectors representing around half of salaried employees. Of the 29 respondents, 15 belonged to trade unions and 14 to employers' associations. The response rate for all sectors invited to take part in an interview was 78%.
2 At the time of the survey, negotiations had been concluded in 13 sectors in the spring and summer wage round. At that time, wage negotiations were still pending for 16 sectors in the winter wage round in late 2022 and early 2023.
3 All responses were weighted by the percentage of employees represented by the survey participants.

get as very important or important for wage demands and wage offers in the second and third quarters of 2022, significantly less than half of respondents did so in the wage rounds from the fourth quarter onwards. This suggests that the importance of the medium-term inflation target declined with rising current inflation. However, the overwhelming majority of employers have described the inflation target as not very important or irrelevant for their wage offers over the course of time. During wage negotiations, the importance attached to certain factors relevant to the wage-setting process may change over time. The survey therefore included an additional question asking to what extent the 2% inflation target was taken into account when reaching the wage settlement. There was no change for employers here in a comparison of the wage rounds. Trade unions' behaviour did change, on the other hand, as unlike in the past, the Eurosystem's medium-term inflation target of 2% ceased to play any role for them at all in the wage agreements in the winter of 2022-23. A comparison with the survey conducted in the low inflation environment in 2016 likewise suggests that the 2% inflation target became less important in recent wage negotiations. In 2016, around one-quarter of the trade unions surveyed still took the inflation target into account in the imminent wage agreements. The recent situation involving very sharp price increases is likely to be the reason for this finding. However, it would be worrying from a monetary policy perspective if trade unions' inflation expectations were to remain permanently above the 2% target. This would increase the risk of the high inflation rates becoming more strongly entrenched than previously assumed.

In most cases, the increases in negotiated wages in 2022 only partially offset the erosion of monetary value. This raises the question as to whether real wage losses should be offset by raising wages again at a later date. In the summer of 2022, only a few respondents among the wage bargainers expected another round of inflation-offsetting wage adjustments in the period from 2023 onwards – after overcoming the energy crisis but without a rapid return of inflation toward the 2% mark. Unsurprisingly, employers were very cautious about an additional round of wage increases. From the trade unions' perspective, one factor may have been the fact that in the summer of 2022, sizeable government support payments were up for discussion and a severe recession was looming. Meanwhile, concerns about job security are likely to have diminished and the government support payments made until now (such as the temporary funding of inflation compensation bonuses and energy price allowances that were being debated at the time) are likely to have postponed the question of further offsetting the losses in real wages. This is also why wage developments in Germany are subject to potential upside risk.

Measure of expected inflation from trade unions' perspective*

%



* Employee-weighted response percentages. Question: "Looking at the most recent/upcoming wage agreement in your sector, which consumer price inflation expectations were/will be considered?"

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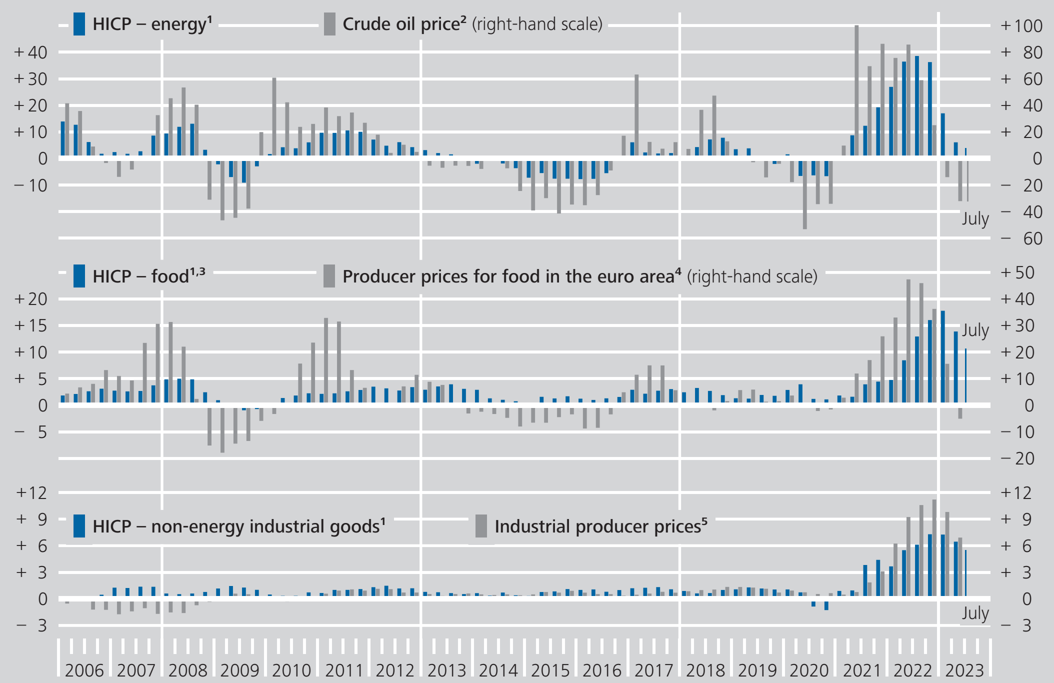
Price developments at economic stages as classified for HICP purposes

Year-on-year percentage change



1 Eurostat. **2** Bundesbank calculations (in euro) based on daily prices in USD as quoted by Bloomberg Finance L.P. **3** Including beverages and tobacco products. **4** ECB calculations of DG AGRI prices based on the European Commission's farm gate and wholesale prices. **5** Analogous to HICP classification "non-energy industrial goods"; Bundesbank calculations based on data from the Federal Statistical Office.

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tions have been falling for around one year now. Nevertheless, the number of vacancies remains comparatively high.

Transition from unemployment to employment down sharply

Nevertheless, the low movement between employment and unemployment suggests a certain degree of uncertainty in the labour market. On the one hand, the likelihood of moving from employment into unemployment is currently still very small and close to its historical low. On the other hand, the likelihood of moving out of unemployment and into employment has fallen sharply over the past 12 months. One contributory factor is the high proportion of refugees, as integration into employment is difficult and lengthy for people whose primary reason for coming to Germany is not economic migration. Even without this effect, however, it is currently not easy for unemployed persons to migrate into employment. According to the unemployment component of the IAB labour market barometer, unemployment is likely to increase gradually again in the coming months.

Wages and prices

Negotiated wages rose sharply, with actual earnings probably increasing even more strongly still

Negotiated wages continued to rise sharply in the second quarter of 2023. Including additional benefits, they were up by 3.9% on the year in the second quarter, compared with 3.8% in the quarter before. High inflation compensation bonuses, in particular, were a key factor.[7] Adjusted for these one-off payments, negotiated pay rose by 2.5% year on year in the second quarter, slightly more slowly than in the first quarter, when it increased by 2.7%. The permanent wage increase of 5.2% from June in the metal-working and electrical engineering industries was partly offset by wage-

7 A recent example is the sum of €1,240 which public-sector employees working for central and local government received in June 2023.

dampening effects from months with no wage rises (zero months) in several other sectors. The latter are partly due to delayed wage settlements.[8] Actual earnings probably outpaced negotiated wages again in the second quarter of 2023. This is because the minimum wage led to strong wage increases in labour-intensive low-wage jobs without collective wage agreements and higher performance-related bonuses were paid at large enterprises.

New wage agreements continue to involve a mix of inflation compensation bonuses and high permanent wage increases

The most recent wage agreements were again high for the most part. As before, they consist of a combination of significant inflation compensation bonuses and high permanent wage increases. The latest mediator suggestion at rail operator Deutsche Bahn would also involve strong wage increases if accepted by employers and trade unions. Lower pay groups would benefit disproportionately.

Delays in reaching wage agreements in trade

Negotiations in the retail sector as well as in wholesale and foreign trade, which were launched back in April, are ongoing. The trade union ver.di had made high wage demands by historical standards (16% for retail trade, 13% for wholesale and foreign trade, in each case to run for a period of 12 months). Meanwhile, the ifo Institute sees an increasingly gloomy business outlook and fairly subdued sales growth. Nevertheless, with inflation still high and the labour market remaining fairly robust, other sectors are likewise likely to reach high wage settlements over the next few months.

The planned increase in the statutory minimum wage poses hardly any upside risks to aggregate wage developments

The general statutory minimum wage is to be raised from the current level of €12 per hour to €12.41 as at 1 January 2024 and to €12.82 as at 1 January 2025. This was the recommendation put forward by the Federal Government's independent Minimum Wage Commission on 26 June 2023. Germany's labour minister immediately announced that he would endorse this recommendation and would table it in the Federal Cabinet. Compared with the last three high minimum wage increases in 2022, the planned raises from next year onwards are fairly small. From today's perspective, the announced minimum wage increases, taken in isolation, do not entail any significant upward risks to aggregate wage developments.

Inflation stubbornly high in spring 2023

Consumer prices (as measured by the Harmonised Index of Consumer Prices, or HICP) rose sharply again in the second quarter. Averaged over April to June 2023, they appreciated by a seasonally adjusted 1.0%, compared with 0.9% in the first quarter. The prices of processed food, non-energy industrial goods, and services, in particular, continued to rise sharply. Energy prices fell again, but no longer as sharply as in the first quarter. In a year-on-year comparison, the inflation rate fell from 8.8% to 6.9% in the second quarter of 2023. This was mainly because energy prices had risen sharply in the previous year in the wake of Russia's invasion of Ukraine and this base effect has now disappeared. At around 14%, year-on-year inflation in food prices was still very considerable, but somewhat reduced compared to the first quarter. And the prices of non-energy industrial goods, too, rose less sharply than in the previous quarter, following the decline in upstream price pressure. By contrast, year-on-year inflation in services prices picked up significantly. In addition to rising wage costs, special factors from the temporary relief measures taken last year (including the €9 travel ticket) were a factor here. Accordingly, the core rate, which excludes the volatile components energy and food, held stubbornly firm at 5.6% in the second quarter, compared with 5.5% in the quarter before.

Inflation rate down slightly in July; core rate historically high

In July, consumer prices rose slightly, by a seasonally adjusted 0.1% month-on-month. Food and services prices, in particular, continued to appreciate, while the prices of energy and other goods declined slightly. Compared with the previous year, inflation fell slightly to 6.5%, having stood at 6.8% in June.[9] By contrast, the

8 It should also be noted that many wage agreements included arrangements to pay inflation compensation bonuses at first, with permanent wage increases not taking effect until a later date.
9 CPI inflation stood at 6.2%, after 6.4%.

Potential for correction of residential property price exaggerations in Germany

The dramatic rise in inflation rates and financing costs in 2022 hit the German residential real estate market at a time when it had been overvalued for some time,[1] with both factors putting a strong brake on price dynamics. Recent declines in residential property prices are not yet reflected in the annual average figures for 2022. This is because prices had still been rising steeply until mid-2022. They fell from that point onwards, but at the end of 2022 were still close to the level seen at end-2021. Evidence that overvaluations persist could potentially mean further – possibly significant – price corrections. There is a risk of abrupt corrections, especially in the purely speculative component of overvaluation, which refers to that part of the overvaluation that is derived solely from the prospect of further price increases in the future. In conceptual terms, this speculative component is equivalent to a price bubble.[2]

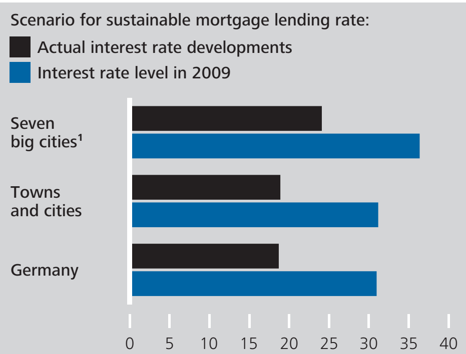
The calculation of the purely speculative price components for residential real estate is based on the expectations expressed in the Bundesbank Online Panel Households (BOP-HH), which are combined with the results for regional overvaluations.[3] There is evidence of these exaggerations that are susceptible to correction if overvaluations are expected to increase further in an already overvalued region.

As in the previous year, residential real estate in Germany was overvalued by between 20% and 30% on average in 2022, according to the Bundesbank's panel model.[4] Averaged across 2022, residential property prices in more than 90% of the 400 German administrative districts were detached from fundamental determinants.[5] Households' expectations on changes in the district-specific price-to-rent ratio as given in the BOP-HH are used as indicators of expected valuation gains. While respondents in around 30% of the overvalued districts (i.e. around 20% of all districts) expected a further rise in price-to-rent ratios in 2019, this share increased to around 50% by 2022.

According to the latest survey conducted in May 2023, however, households in just

Residential property price deviations in 2022 according to regional panel model

Deviation from estimated fundamental price in %



1 Berlin, Cologne, Düsseldorf, Frankfurt am Main, Hamburg, Munich and Stuttgart.
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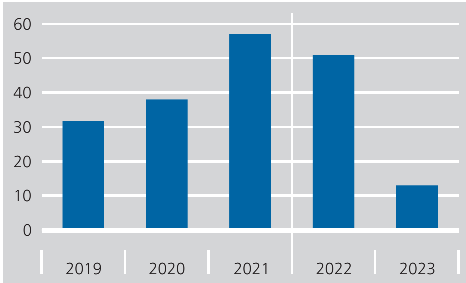
1 Residential property overvaluations are seen as the deviations of prices from their fundamental value. In the Bundesbank's panel model, this is calculated using fundamental economic and socio-demographic factors, which include housing stock, per capita disposable income, population density, mortgage interest rate and expected GDP growth. For an in-depth description of the valuation approaches used, see Deutsche Bundesbank (2020a).
2 See Stiglitz (1990).
3 See Deutsche Bundesbank (2020b).
4 See Deutsche Bundesbank (2023b). Since February 2023, newly added price data for non-urban regions have largely confirmed the valuation results for Germany as a whole.
5 By definition, districts with overvaluations are those in which residential property prices are more than 10% above the reference value.

over 10% of the regions with overvaluations expected a further increase in valuation levels.[6] In line with this, the share of overvalued districts in which some degree of normalisation – in this case declines – in the price-to-rent ratio was expected went up again to around 80%. Many households surveyed thus adjusted their expectations of future valuations downwards over the past year.[7]

Districts with expected increases in the price-to-rent ratio*

Share of all overvalued districts in %



* Bundesbank calculations conducted using survey-based data provided as part of the Bundesbank Online Panel Households (BOP-HH). Overvaluations according to the panel model. Expected development in the price-to-rent ratio in the next 12 months. The results for 2023 are based on the district-specific valuation results for 2022.

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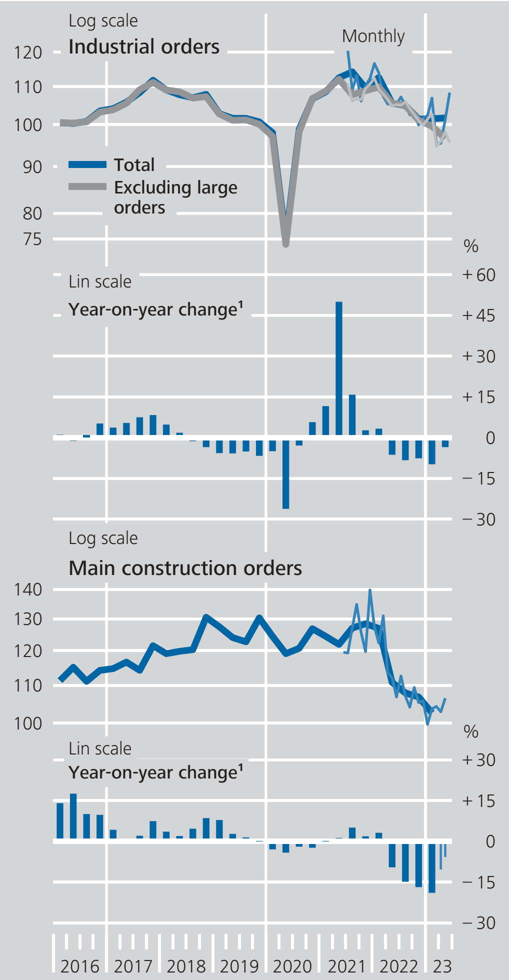
The survey data for 2023 point to a broad-based, modest reduction in the speculative components, and not to drastic corrections. In more than 90% of the districts, the recently expected decline in the price-to-rent ratio – i.e. in the valuation level – was less than 10%. In around half of those regions where valuation levels are likely to fall, respondents assumed a decrease in prices of less than 2.5%, while roughly three-quarters of these districts expected to experience price declines of no more than 5%. This means that the expected reduction in overvaluations is likely to take place without an overly significant drop in house prices. This is partly due to the fact that rents are barely expected to fall.

These findings are subject to considerable uncertainty, as the statistical recording and assessment of house price developments has become more difficult of late. Since the start of the energy crisis in 2022, the importance of energy efficiency in determining prices in the real estate market is likely to have increased. By their very nature, survey-based price data are not quality-adjusted. The decline in prices expected in the May 2023 survey could therefore, in some cases, also reflect higher price discounts for properties with lower energy efficiency.[8] As a result, it is more difficult to attribute the fall in price-to-rent ratios to speculative motives becoming less important. The orderly reduction of speculative motives could therefore be smaller than the calculations suggest and the risk of outstanding abrupt price corrections could be greater. However, the impact of possibly incomplete quality adjustment, which only affects the properties of a building, is confined to the structure component. The value of the land is not affected.

6 Data constraints mean that the results for regional overvaluations are not yet available for 2023. The calculations for 2023 are based on the district-specific valuation results for 2022. The number of overvalued districts could tend to be lower in 2023. This alone could mean that the share of districts with speculative motives is higher than reported. However, it would also mean that fewer districts were affected so that, on balance, there would probably be little change in the risk assessment.
7 The relevant questions in the BOP-HH are always asked in May of a given year.
8 In the case of residential property price indices compiled by statistical offices and the private sector, the key factor is how well hedonic quality adjustment, on which the results are based, deals with this difficulty.

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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core rate excluding energy and food rose slightly and is now at a record level of 6.2%. One-off effects were a factor in this – mainly the effects of the increase in the HICP weight of package holidays in 2023 as well as last year's fiscal relief measures mentioned above.[10] However, even without these one-off effects, the core rate would likely have remained at a very high level of around 5½%.

Inflation is likely to ease later in the year

In the coming months, inflation will, as things currently stand, probably come down further, mainly thanks to an increasingly dampening contribution from energy prices. In addition, abating price pressures along supply chains and lapsing one-off effects are likely to contribute to lower inflation. By contrast, wage growth will probably remain strong, even going into the new year. This is a key reason why the inflation rate is likely to stay above 2% in the longer term.[11] Higher inflation expectations and potentially recurring energy price shocks also pose upside risks to the price outlook.

Order books and outlook

Economic output is likely to more or less stagnate again in the third quarter of 2023

German economic output will probably remain largely unchanged again in the third quarter of 2023. Given stable employment and strong wage growth as well as declining inflation rates, the recovery in private consumption is likely to continue. This should also provide the services sector with a boost. Some subsectors of industry and construction are continuing to benefit from their large order backlog. Diminishing supply bottlenecks mean that orders can be processed more quickly. However, industrial output looks set to remain weak initially, as foreign demand was on a downward trend in the period under review. High financing costs will probably continue to weigh on investment. They are also still dampening demand in the construction sector, something that is likely increasingly to be reflected in output.

Private consumption buoying economy

Private consumption is expected to buoy the economy in the third quarter. The consumer climate index forecast by the market research institute GfK for August improved again and exceeded its second-quarter average. Income expectations, in particular, rose significantly, and the propensity to purchase also edged up slightly. Car purchases could again make a positive contribution to private consumption. This is signalled by new passenger car registrations, which picked up again in July and significantly exceeded the previous quarter's level according to data provided by the German Association of

10 See also Deutsche Bundesbank (2023c).
11 See also Deutsche Bundesbank (2023a). According to updated estimates, the average inflation rate is likely to remain at around 6% in 2023.

the Automotive Industry (VDA). However, ifo Institute surveys suggest that the rise in private consumption may be weak. This is because enterprises in the consumer-related retail and hospitality sectors rated the business situation as worse than in the previous quarter.

Industrial output expected to be weak

Industry is likely to dampen macroeconomic developments in the third quarter. The slowdown in demand for industrial goods continued in the period under review. During the second quarter, industry received slightly more new orders than in the previous quarter. However, this was attributable solely to large orders, which are usually processed over an extended period of time. Excluding these, demand from both Germany and abroad fell sharply. Short-term production plans and export expectations, which became markedly more pessimistic according to ifo Institute surveys, also point to a slowdown in industrial activity. By contrast, the large order backlog and the fact that supply bottlenecks continued to ease had a positive impact on industrial output.[12] According to the Federal Statistical Office, the order books and the range of orders have, on balance, been falling for some months now but remain at a high level.

12 Surveys conducted by the ifo Institute and S&P Global indicate that bottlenecks continued to ease at the beginning of the current quarter.

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