

Economic conditions in Germany

Underlying trends

Steep upturn sustained primarily by domestic activity

The economic upturn in Germany continued to gain in strength after the start of 2014. The upward movement in domestic activity has been evident for some time and has been boosted latterly by the fact that, along with private consumption and housing construction, investment in machinery and equipment is now trending upwards again following a lengthy period in the doldrums. This broadly sustained demand-side economic growth is being rounded off by impulses that have been coming for a year from the export side; although these stimuli are rather moderate overall, they are nevertheless quite steady. So far, disruptive factors stemming from the international setting have not distinctly affected the sentiment of enterprises and consumers in Germany; instead, the trend recovery in the euro area has probably helped to improve the climate for investment, which was characterised for a long time by uncertainties.

GDP growth overstates underlying cyclical trend owing to effect of the weather

The pick-up in economic activity in the first quarter of 2014 is obvious from the substantial seasonally and calendar-adjusted 0.8% quarter-on-quarter growth in real gross domestic product (GDP) that was reported for this period. What is also evident, however, is that first-quarter growth noticeably exceeds the underlying cyclical dynamics. The effect of the weather had a major impact, since the extremely warm and dry winter did little to impair economic activity in outdoor professions. According to the Bundesbank's estimations, the particular weather situation means that the quarter-on-quarter GDP rate is probably 0.3 percentage point higher than in the case of a "normal" winter (see box on pages 54 to 55). The high level of output achieved in the first quarter of 2014 owing to the effect of the weather also means, however, that the seasonally adjusted and calendar-adjusted rate of GDP

growth in the second quarter will understate the cyclical factor.

The mild winter allowed a considerable seasonally adjusted rise in the level of construction output. Losses in the industry's utilisation of equipment remained well below the usual seasonal level. In seasonally adjusted terms, capacity utilisation showed a further substantial increase on the already exceptionally high figures of the preceding quarters. The construction sector has already been working at virtually maximum capacity for three years now, which is due mainly to considerably increased demand for housing. Since last year, public sector construction has been picking up again following a sharp dip in 2012 owing to the ending of the cyclical stimulus. Most recently, there has also been a marked increase in demand for commercial buildings.

Substantial increase in construction ...

Overall output

2005 = 100, price and seasonally adjusted



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

The impact of weather conditions on gross domestic product in the latter part of 2013 and early part of 2014

Exceptional weather conditions over the winter months can have a considerable influence on the seasonally adjusted growth pattern of gross domestic product (GDP). Seasonal adjustment involves making predefined corrections for the effects that recur annually. This implies that the impact of a "normal" winter on output is eliminated from the original data. As a result, the effects of abnormal weather conditions remain visible in the adjusted data, which can make the interpretation of the macroeconomic trend more difficult.

In the light of the exceptionally mild weather in the latter part of 2013 and early part of 2014, the question therefore arises as to whether there is a more accurate way of quantifying the impact exerted by the weather on macroeconomic activity. Generally this can be done using an aggregated approach measuring the magnitude of the weather effect on GDP directly as well as indirectly via its components. On the supply side, this involves using gross value added figures broken down by economic sector. Corresponding data are available at a quarterly frequency. Another alternative is the estimation of weather effects using monthly time series on output and parts of the services sector.

There are also several possibilities when selecting a suitable weather indicator as an explanatory variable. From a macroeconomic perspective, the number of ice days¹ is particularly informative. The restriction to a single weather variable offers estimation advantages and thus facilitates a more precise quantification of weather effects.² Thus an additional ice day reduces GDP in the first quarter by approximately 0.07% on average and in the fourth quarter by only

just under 0.03%.³ The number of ice days thus exerts a significantly stronger negative influence on GDP in the first quarter of a year than in the preceding quarter, which may be explained by the fact that in general economic output is relatively low between Christmas and New Year irrespective of weather conditions.

Using the available weather data, a positive effect of approximately 0.3 percentage point can be estimated in the first quarter of 2014 for the quarter-on-quarter GDP growth rate adjusted for seasonal and calendar effects. By contrast, there is only a weak influence on the fourth quarter of 2013 in spite of the number of ice days being significantly below the long-term average.

An assessment using the components of gross value added shows that macroeconomic effects which are caused by special weather conditions stem from construction to a large degree. Whilst the number of ice days likewise has a negative effect on manufacturing production and overall economic output in the services sectors, the weather has the opposite impact on energy

¹ The German Meteorological Service defines an ice day as one on which the maximum air temperature is below freezing. To construct a times series for Germany as a whole, the ice days measured in 29 selected representative German weather stations from Monday to Friday were weighted according to inhabitants and employees subject to social security contributions in the main construction industry.

² For an approach using several weather variables applied to Dutch GDP, see P Ouweland and F Ruth, How unusual weather influences GDP, CBS Discussion Paper, 2014/10.

³ The estimation of the semi-elasticities was carried out within the framework of a RegARIMA model, in line with the calculation of calendar effects. See Deutsche Bundesbank, Calendar effects on economic activity, Monthly Report, December 2012, annex, pp 51-60.

production. Monthly indicators deliver results which are more clear-cut, but are not available for all economic sectors. Overall, the aggregated and both disaggregated approaches produce similar results.

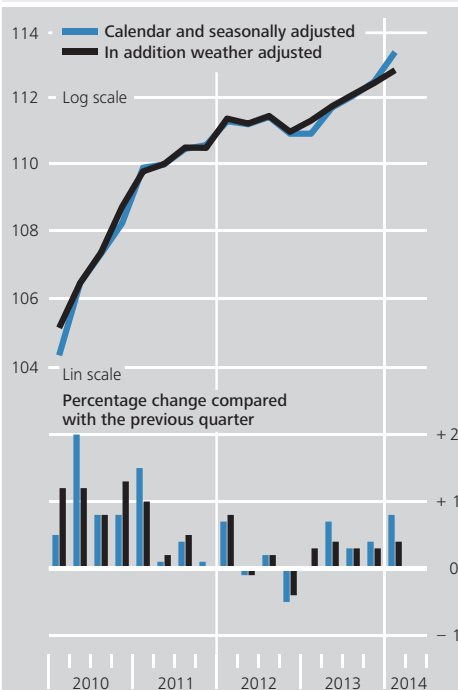
In comparison with the pattern for official price, calendar and seasonally adjusted GDP, the series additionally adjusted for weather is visibly smoother and the variance in quarter-on-quarter changes significantly lower. In particular, the influence of the weather can explain the unusual swings in GDP growth rates in the first half of 2010, in the latter part of 2010 and early part of 2011 and also in the first half of 2013.

Overall, the form of weather adjustment used thus delivers satisfactory and plausible results. However, residual weather effects and over-adjustment problems may reduce the reliability of an additional weather-adjusted series. In line with European recommendations, weather adjustment is therefore not part of the official seasonal and calendar adjustment.⁴

Following a first quarter which was robust owing to the weather, the results of the weather adjustment ultimately also suggest implications for the further performance of GDP in 2014. Here a distinction needs to be made between two effects. Initially, GDP returns to the normal cyclical level. This results in a negative growth rate effect of an estimated 0.3 percentage point after seasonal and calendar adjustment for the second quarter. Furthermore, the question arises as to whether special weather conditions only cause economic activity to be distributed differently over time or whether there is a level effect; therefore whether the economic output in 2014 will be higher overall due to the favourable weather conditions in the first quarter. In the first instance, following a positive weather effect

Gross domestic product

2005 = 100, at previous-year prices



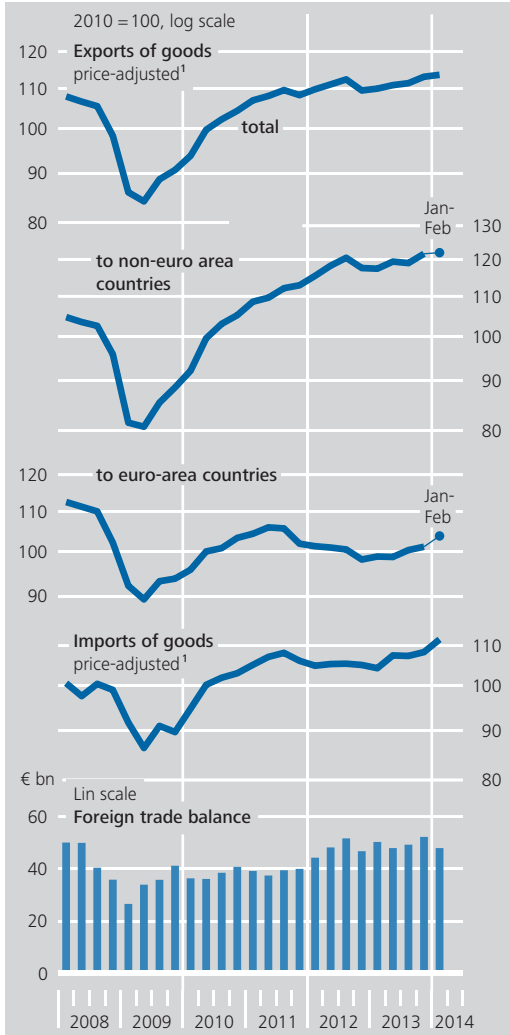
Source of unadjusted figures: Federal Statistical Office.
 Deutsche Bundesbank

the growth rates would be lower than those of the cyclical trend in subsequent quarters; in the second instance they would be affected to a lesser extent or not at all. The empirical results which have been available for relatively long periods of time are unclear here. There is much to suggest, however, that it depends on the particular cyclical position. At present, in view of the steep rise in demand for construction work and the high utilisation of equipment in the construction sector, the withdrawal effects in subsequent quarters will probably be small.

⁴ See Deutsche Bundesbank, Calendar effects on economic activity, Monthly Report, December 2012, pp 51-60, in particular footnote 6.

Underlying trends in foreign trade

Seasonally adjusted, quarterly



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

... but also distinctly more investment in machinery and equipment

Enterprises' willingness to increase their investment budgets does not affect only construction work. Usually, investment in machinery and equipment picks up in the wake of an improving outlook for the economy. This is especially true if aggregate capacity utilisation has already reached a normal level – as at the current end. Added to this is the fact that, in the face of heightened uncertainty, technology-related replacement and plant projects have probably also been deferred over the past two years. Following the subdued increase at the end of 2013, enterprises' spending on moveable fixed assets showed a marked increase in the first three months of the current year. Sea-

sonally adjusted domestic sales of capital goods producers were 1¾% up on the quarter, for example. Added to this was a significant increase in imports of machinery and equipment in January and February 2014.

Private consumption remained a major pillar of the cyclical upturn in the first three months of this year. According to surveys by the consumer research institution, *Gesellschaft für Konsumforschung* (GfK), consumers are rating their income prospects more optimistically again, and, despite a certain correction, the propensity to purchase remained at a high level. Retail benefited from consumers' readiness to spend; in the period from January to April, the business situation was assessed as more favourable than at any time over the past two years. This is consistent with the report that retail sales in the first three months of 2014 showed a perceptible rise on the quarter in seasonally adjusted terms. Given the known shortcomings of the initial results, caution is still advised when interpreting these data, however. Measured by new registrations for non-commercial use, sales of motor cars are unlikely to have made any significant contribution to the rise in private consumption. Furthermore, since the start of 2014, sales of light heating oil to homeowners have been very low owing to small-scale consumption on account of the weather.

Marked rise in private consumption

The underlying trend in foreign trade has been pointing upwards for a year again now. It is, above all, the import side that has gained in dynamism recently, whereas German firms' export activities – given the mixed situation in global economic activity overall – are setting no more than a subdued pace of expansion at present. This background implies fundamentally dampening effects on the foreign trade surplus. So far, however, these have been counteracted by marked gains in the terms of trade due to clearly declining prices for internationally traded commodities and semi-finished products. Even so, in seasonally adjusted terms both the trade balance and the current account balance moderated substan-

Domestic momentum reduced surplus on trade and current account balances

tially in the first three months of 2014 compared with their heightened levels at the end of last year.

Subdued exports ...

According to the Federal Statistical Office, seasonally adjusted exports in the reporting period were not up on their level in the final quarter of 2013. This was probably due chiefly to the fact that exports to countries outside Europe after the start of the year failed to keep up their marked pace of expansion in the fourth quarter of 2013. According to the regional data that is currently available only for January and February, German firms' exports to the United States and Japan once again failed to make any headway after showing a marked loss of momentum in 2013, which followed steep increases in the two years before. By contrast, sales of goods in China and the south and east Asian emerging markets showed a seasonally adjusted rise, although the increases remained comparatively moderate. On the other hand, EU countries made up some ground again as importers of German products. Significantly more goods were exported to countries in central and eastern Europe in particular; the upward trend in exports to this region has been strengthening quite steadily since its temporary stagnation in 2012. Sales of goods to the rest of the euro area increased distinctly in the first few months of 2014. Positive results are now predominant again in export business with the euro-area partner countries owing to their economic recovery. There was a continuation of the sharp expansion in exports to the United Kingdom.

... but significantly more imports

Exports expanded sharply at the beginning of 2014. The reporting quarter thus fits in with the picture of an underlying trend of increasingly growing momentum. This upward movement related to all major categories of goods with the exception of energy. The mild winter probably helped to limit imports of energy. German enterprises' demand for imported intermediate goods was particularly high during the period under review. This suggests that the business sector in Germany has geared itself to stepping

up output. At the start of 2014, suppliers elsewhere in Europe as well as overseas benefited to a similar extent from the demand boost generated by buoyant economic activity in Germany, while European manufacturers performed better last year.

■ Sectoral trends

Quarter-on-quarter growth in industrial output in the first three months of 2014, at 1¼%, was practically just as strong as in the fourth quarter of last year. Given the very sharp increase in orders of 2¼% in the final quarter of 2013, a strengthening of the upward trend would have been expected.¹ Nevertheless, industrial output was 4¾% higher than in the final quarter of 2012 when sectoral activity had undergone a short-term dip. Intermediate and capital goods producers have worked their way more or less in parallel out of the intervening low. In terms of capacity utilisation, however, there are identifiable differences between these two main sectors of industry. According to the Ifo survey results for April, capacity utilisation in the case of intermediate goods producers was already markedly exceeding its longer-term average, while the cyclical position of capital goods producers lagged behind this. Overall, manufacturing firms are using their installed physical capital on the scale of the longer-term average.

Further rise in industrial output ...

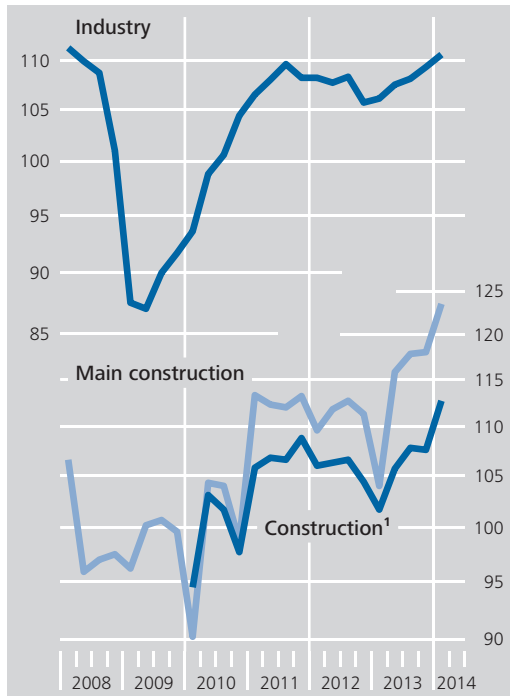
Compared with other sectors, motor vehicle manufacturers made a very strong start to the year (+2½% on the quarter in seasonally adjusted terms). This contrasted with weaker growth at the current end in mechanical engineering. After achieving a marked increase in output in the final quarter of 2013, this industrial sector failed to make any improvement on that level in the reporting quarter after seasonal adjustment. In the intermediate goods sector, the metal-working industry performed

... headed by motor vehicle manufacturers

¹ A higher outcome was also implied by the provisional figures for January and February, although these were revised downwards for the March report.

Output in industry and in construction

2010 = 100, seasonally adjusted, quarterly, log scale



Source of unadjusted figures: Federal Statistical Office. 1 Main construction and finishing trades.
 Deutsche Bundesbank

relatively well with a rise of 1¾%. The chemical and pharmaceutical industry reduced its output by 1¼% on the quarter. Consumer goods output was somewhat higher in seasonally adjusted terms.

Construction output hit new peak, not least because of mild weather

Given the very mild weather, construction output rose very strongly in the first quarter of 2014 at a seasonally adjusted 4¾%. There was slightly above-average growth in building construction at 5%. It is striking that the finishing trades, which are generally far less dependent on the weather, performed better with an increase of 4¾% than civil engineering activity (+4¼%). This suggests that particularly housing construction firms made use of the favourable weather conditions to process existing orders. Energy production was still tending to be weak. In the reporting quarter, there was a decline of 1½% after seasonal adjustment, which was probably also due to the weather.

The business situation in the wholesale and retail trade showed a marked improvement in the first quarter of 2014. This finding is based on both the reported sales figures in the official statistics and the results of the Ifo surveys. Outside the wholesale and retail sector, the current situation was, in fact, rated even more favourably by service providers overall. In the transport sector, there is likely to have been a marked expansion of services after the start of the year. For example, compared with the final quarter of 2013, the first quarter of this year saw a seasonally adjusted increase of 1¼% in the total mileage of domestic heavy goods vehicles subject to tolls on German motorways and trunk roads. This probably owed something to the effects of the weather. By contrast, there was no more than a marginal increase in turnover in the case of hotels and restaurants.

Economic situation also improved in the services sector

Employment and labour market

The upturn in economic activity clearly provided a boost for the labour market in the first quarter of 2014. Added to this were the effects of the mild weather on sectors of the economy where employment is usually depressed in the cold months of the year. The first three months of 2014 brought a seasonally adjusted increase in employment of 127,000, or 0.3%, on the quarter, which was distinctly more than in previous quarters. Together with the downward revisions for the first half of 2013 and with upward revisions for the second half, this led to an increase of 0.8% in the year-on-year figure. Additional regular jobs subject to social security contributions were the main reason for the increase in the number of persons in work. Furthermore, there were somewhat more persons in low-paid part-time employment, although there was a quite significant decline in self-employment. On an average of the first two months of 2014 alone – more recent estimates are not yet available – the increase in jobs subject to social security contributions showed an

Economic upturn has spread to labour market

increase of 132,000 on the final quarter of last year. This corresponds to growth of 1/2%.

Job growth in all major sectors

The dominance of the cyclical component is indicated by the fact that the expansion in employment is broadly based. New jobs were created not only in the construction sector but also in manufacturing as well as in temporary agency employment, which is closely linked to manufacturing, and in logistics. In the services sector, there was an above-average rise in the number of jobs, especially in healthcare and social services and in the education sector. Additional employees were also hired on a significant scale in wholesale and retail, hotels and restaurants, information and communication as well as in business-related services (excluding temporary agency employment).

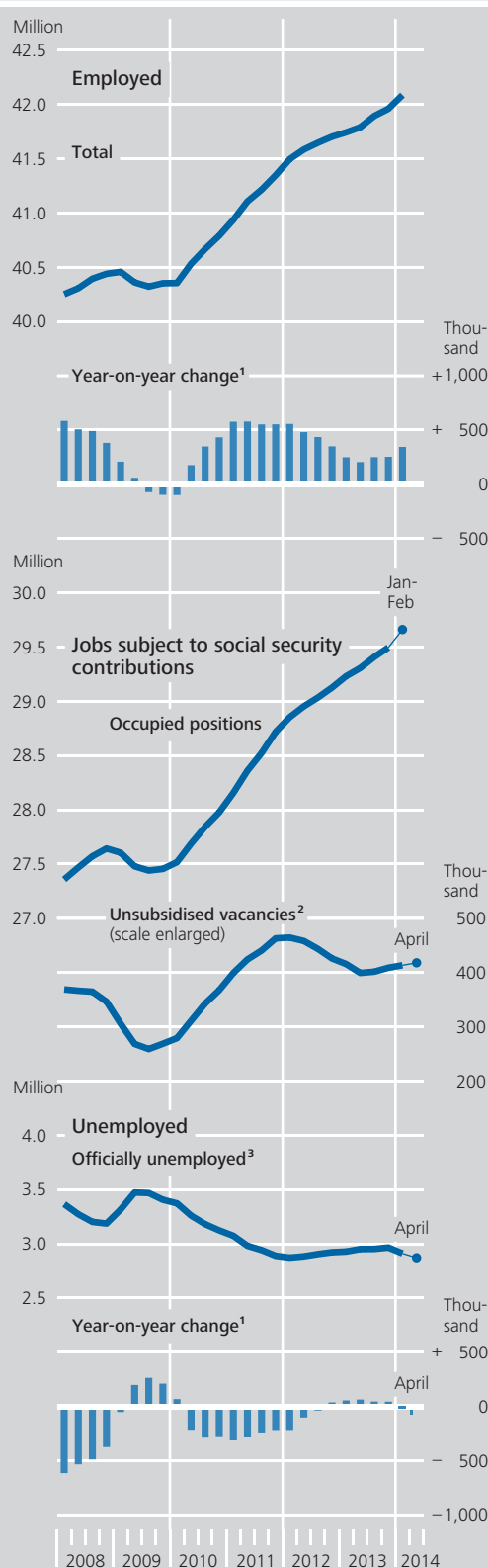
Strong immigration and ...

In view of the fact that unemployment is at a low level, the expanding demand for labour in Germany is favouring the activation of persons who were hitherto not available to the labour market and is leading to an ongoing strong immigration of persons who are willing to work, especially from the countries of the EU. According to the Federal Statistical Office, the migration surplus from January to November 2013 amounted to roughly 430,000 persons, which was 17% more than in the same period of 2012. There was no overall increase from the countries of central and eastern Europe, including Romania and Bulgaria. By contrast, there was a further increase in the number of immigrants from the euro countries in southern Europe, principally Italy. Since the accession of Croatia to the EU in mid-2013, immigration from that country has increased greatly; the migration surplus, at 12,000 persons in the first 11 months of 2013, is not a significant factor, however. With regard to freedom of movement for workers, restrictions still apply to Croatian citizens; for Romanian and Bulgarian citizens such restrictions were lifted at the end of last year.²

² Above and beyond that, in 2013 there were more refugee movements, especially from Syria, Africa and Russia (with a sharp increase in applications for asylum).

Labour market

Seasonally adjusted, quarterly



Source of unadjusted figures: Federal Statistical Office and Federal Employment Agency. **1** Not seasonally adjusted. **2** Excluding seasonal jobs and jobs located abroad. **3** From May 2009, unemployed excluding persons newly registered on the books of private employment agencies.

*... successful
labour market
integration*

The largest group of immigrants – with a surplus of approximately 120,000 new arrivals in 2013, this consisted once again of persons from the EU8 countries – has been successfully integrated into the labour market. According to the figures of the Federal Employment Agency, there were 76,000 more citizens of these countries in paid employment last year than in 2012, the vast majority of them being in jobs subject to social security contributions. Even so, immigrants mostly perform comparatively low-paid work mainly in sectors such as construction, logistics, hotels and restaurants, and temporary agency employment. This assessment is not qualified either by the fact that unemployment among EU8 citizens has risen somewhat recently (7,600 more than in 2012 on an annual average). This moderate increase is likely to be largely explained by frictional unemployment (the number of unemployed persons looking for jobs) among the rapidly growing number of EU8 citizens residing in Germany. Immigrants from other parts of the EU also seem to be succeeding in integrating into the German labour market.

*Marked decline
in unemploy-
ment*

Registered unemployment showed a marked seasonally adjusted fall in the first quarter of this year, following a tendency to a slight increase in the unemployment figures in the two preceding years. On an average of the reporting period, the official unemployment figure was 54,000 lower than in the fourth quarter of last year. The number of unemployed was 2.91 million; the unemployment rate went down by 0.2 percentage point to 6.7%. The decline continued quite clearly in April. The official unemployment figure stands at 2.87 million at present. Besides the pick-up in economic activity, the mild weather was probably a help. The decline affected both short-term unemployment covered by the statutory insurance scheme and recipients of unemployment benefit II. Compared with the situation in the same quarter last year, not only has there been an increase in the number of persons leaving unemployment, there has also been a reduction in those entering unemployment. Nevertheless,

in practical terms it is only persons under the statutory insurance scheme who are benefiting from the labour market's heightened absorption capacity, while the current decline among recipients of unemployment benefit II is due, above all, to a smaller number of new applicants.

For the time being, recruitment practice in trade and industry and in business-related services is likely to remain as expansionary as in the first quarter. This is suggested by the Ifo employment barometer, which provides information on employment plans over the coming three months based on firm surveys. For more than half a year now, this leading indicator has persisted at a high level. The Federal Employment Agency's BA-X job index confirms these expectations with its slight upward tendency. Both main components of the index – new vacancies as well as the existing number of reported (unsubsidised) vacancies – are pointing upwards. An increasing number of jobs subject to social security contributions are being offered, especially in cyclically sensitive sectors, such as industry, construction and trade, as well as in professional, scientific and technical services. According to the labour market barometer of the Institute for Employment Research (IAB), there is unlikely to be any further significant fall in unemployment over the next three months. Since reaching an interim peak in February, the indicator has been slowly going back down into neutral territory.

*Labour market
outlook remains
positive*

■ Wages and prices

Growth in negotiated rates of pay in the first three months of 2014, at 3.3% year on year, was considerably stronger than in the final quarter of 2013 (+2.4%). This was due mainly to the retrospectively granted part of the negotiated rate increase in the retail sector being paid as a lump sum at the beginning of this year in many cases. The annual rate in the case of negotiated basic rates of pay went up by only 0.4 percentage point to +2.8%. The

*Exceptionally
steep growth in
negotiated rates
of pay in 2014
Q1 owing to
back payment in
the retail sector*

stronger underlying pace of growth in negotiated rates of pay is likely to continue in the second quarter. This is indicated by the pay agreements concluded during 2013 and at the beginning of this year.

Wage increases in this year's pay round much as in 2013 so far

Judging by the outcomes so far, the 2014 pay round has been a seamless continuation of last year's pay round. Taking account of industry-specific differences, the annualised agreed increase in negotiated pay averaged roughly 3%. Increases are generally made in two stages, with the first stage being the largest. The most important and (in terms of the volume increase) largest agreement concerns central and local government with around 1.7 million salaried employees.³ Running for a period of two years, the pay agreement provides for phased increases in the scheduled rates of pay totalling 5.4%, with the remuneration of the low and medium pay groups (up to €3,000 a month) rising overproportionally in the first stage. The pay agreements in the construction sector and for the painting and varnishing trade is somewhat less than this and the agreement in the printing industry is well behind it. Moreover, the fact that these agreements also run for a longer period helps to limit the cost strains on firms.

According to draft legislation, general minimum wage with only a few exceptions

At the beginning of April 2014, the Federal Cabinet adopted the Act Reinforcing Collective Bargaining Autonomy (*Tarifautonomiestärkungsgesetz*) which provides *inter alia* for the introduction of a general statutory minimum wage of €8.50 an hour from January 2015. The only exemptions from this minimum wage level are young persons under 18 years of age who have not completed a course of vocational training, interns employed on periods of work placement or training for no longer than six months, persons doing voluntary work and the previously long-term unemployed in the first six months after taking up work. Sector-specific minimum wage levels below €8.50 will remain in force until the end of 2016 as far as they have been declared generally binding on the basis of the Posted Workers Act (*Arbeitnehmer-*

Negotiated rates of pay

Year-on-year percentage change, on monthly basis



¹ Excluding additional benefits and lump-sum payments.

Deutsche Bundesbank

Entsendegesetz) or the Temporary Employment Act (*Arbeitnehmerüberlassungsgesetz*). This applies nationally to, for example, employees in the hairdressing trade as well as workers in the office cleaning and roofing industries, temporary employment agencies and large laundries in eastern Germany. In 2017, proposals on the level of the minimum wage can be presented to the Federal government for the first time by a minimum wage commission consisting of a chairperson, three voting members designated by the employers' associations and three voting members designated by the unions along with two expert advisers (without voting rights). Adjustments will be made by statutory order.

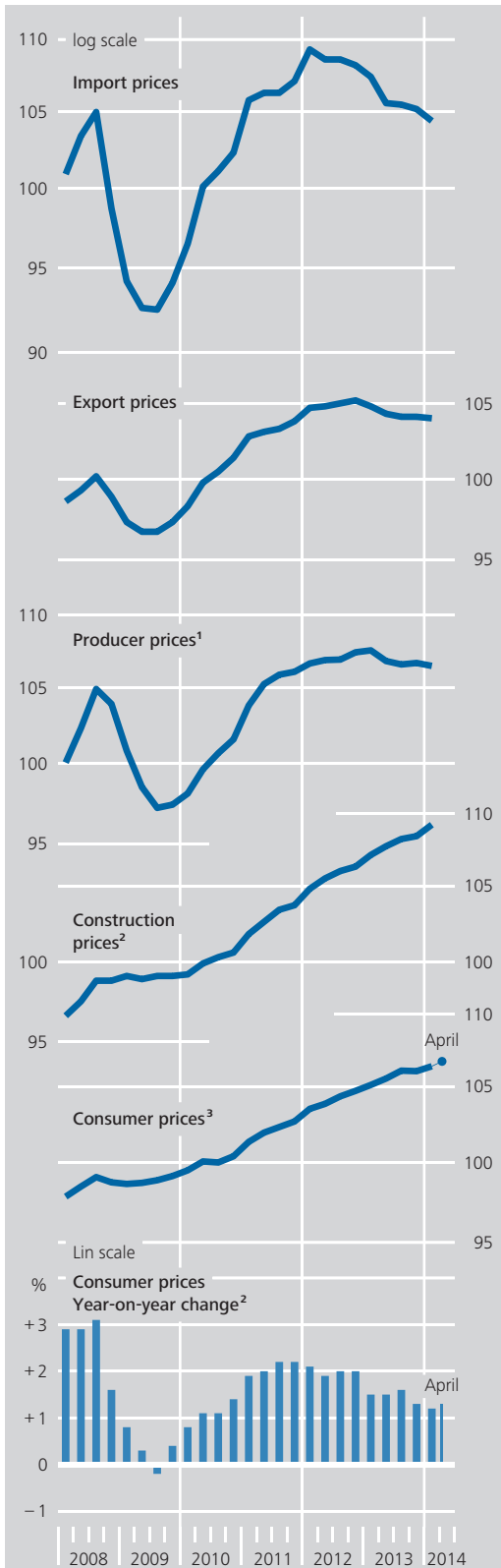
The Act Reinforcing Collective Bargaining Autonomy also provides for the Posted Workers Act to be opened up for all sectors and a reform of the declaration of agreements as generally binding. The relevant draft legislation envisages a considerably streamlined procedure for the future extension of collectively agreed sectoral minimum wages to enterprises which are not bound by collective agreements. At present, there are 15 sectoral minimum wage levels, of which 13 have been declared to be

Expansion of sector-specific minimum wages also planned

³ For Federal civil servants, the draft legislation provides for a reduction of 0.2 percentage point in the agreed pay increases in order to build up a pension reserve.

Import, export, producer, construction and consumer prices

2010 = 100, seasonally adjusted, quarterly



Source of unadjusted figures: Federal Statistical Office. **1** Producer price index for industrial products in domestic sales. **2** Not seasonally adjusted. **3** National consumer price index. Deutsche Bundesbank

generally binding. These are currently set at between €6.50 for employees in the hairdressing trade in eastern Germany and €13.95 for skilled construction workers in western Germany.

Price trends in Germany are currently being determined by opposing forces. While prices that are more sensitive to external influences are falling, prices determined to a greater extent by domestic factors are showing a marked increase. At the upstream stages of the economy, prices in the first quarter of 2014 were down on the preceding three-month period in seasonally adjusted terms, albeit to varying degrees. In the case of domestic producer prices, the decline was focused on the energy component and, less intensely, on intermediate goods, while prices of capital goods remained unchanged and consumer goods prices showed a marked increase. The improved cyclical situation of the German economy is likely to have been a significant factor in this. This stood in contrast to imports, where the fall in prices affected the whole range of goods. The decline was especially marked in the case of energy, with falling crude oil prices acting in combination with the appreciation of the euro. The euro's higher exchange rate against a number of major trading partners' currencies also played a large part in other imported goods becoming cheaper. This was reinforced by the moderation of international prices for industrial commodities. In the case of goods imports, these movements led to the year-on-year decline in prices widening to 2.8% and, for domestic industrial products, to 1.0%. In the case of export prices, however, the year-on-year decline narrowed slightly to 0.9%. In line with this, there was a distinct improvement in the year-on-year terms of trade, although they were still below their long-term average.

Declining prices at upstream stages of the economy

Despite extremely buoyant construction activity, prices for construction work continued to show only a moderate increase in the first quarter of 2014. The year-on-year rate of increase persisted at 2.0% for both structural work and finishing trades. Construction de-

Construction prices rising moderately

mand and the fact that the utilisation of equipment is at a much higher level than average have so far not led to an upward acceleration in prices; this may have something to do with the favourable developments in material costs, where the rise in prices moderated. Moreover, construction work services were also performed internationally; accordingly, overcapacity in other European countries is slowing down price inflation in Germany. According to the Association of the German Pfandbrief Banks (*Verband deutscher Pfandbriefbanken*), the prices of owner-occupied housing rose by 2.4% on the year in the first quarter of 2014. The year-on-year figure showed no further change following the marked decline in the previous quarter. Compared with other leading indicators, the vdp index show price dynamics in the German housing market to be quite moderate at present.

Marked rise in consumer prices in 2014 Q1

Following a slight decline in the final quarter of 2013 due to energy prices, consumer prices accelerated again distinctly in the first quarter of 2014. This resulted in a seasonally adjusted rate of 0.4% on the quarter. Declining oil prices, the appreciation of the euro and the mild winter weather led to a further marked fall in energy prices, but they were not down as sharply as in the final quarter of 2013. Over the course of the quarter, there set in a countermovement to the previous year's sharp rise in food prices, which was also related to the weather. By contrast, prices for services in particular accelerated again distinctly despite the late date of Easter, and rents were going up at a faster pace. Despite the appreciation of the euro, even prices of industrial goods went up somewhat more quickly than in the preceding quarter, which is likely to have been connected with seasonal price reductions being brought forward to December on account of the warm winter weather. Even so, the fact that Easter fell later than in 2013 meant that the annual rate of the national consumer price index (CPI) fell from 1.3% to 1.1% in the first quarter and annual inflation as measured by the Harmon-

ised Index of Consumer Prices (HICP) was down from the same figure of 1.3% to 1.0%.

The upward price trend continued in April. Consumer prices rose by 0.3% on the month after seasonal adjustment, again mainly due to an increase in services prices and housing rents. Furthermore, energy became more expensive and prices of industrial goods were somewhat higher. By contrast, food prices remained unchanged compared with the previous month. The late date of Easter played a part in the annual CPI and HICP going up to 1.3% and 1.1% respectively.

Consumer prices continuing to accelerate in April

■ Orders received and outlook

In the coming months, the economic upturn in Germany will be driven very largely by domestic forces. External impulses, by contrast, are likely to be rather subdued. Moreover, in view of the heightened perception of economic risks in some emerging market economies as well as considerable geopolitical uncertainties in eastern Europe, there has lately been a marked increase in the potential for external disruptions. If no major unforeseen events result from this situation, the economic upturn may be expected to continue. As the positive effect of the mild winter in the first quarter will, in purely mathematical terms, dampen the seasonally adjusted quarter-on-quarter rate in the second quarter, GDP growth in the second quarter is still likely to be relatively low in seasonally and calendar-adjusted terms.

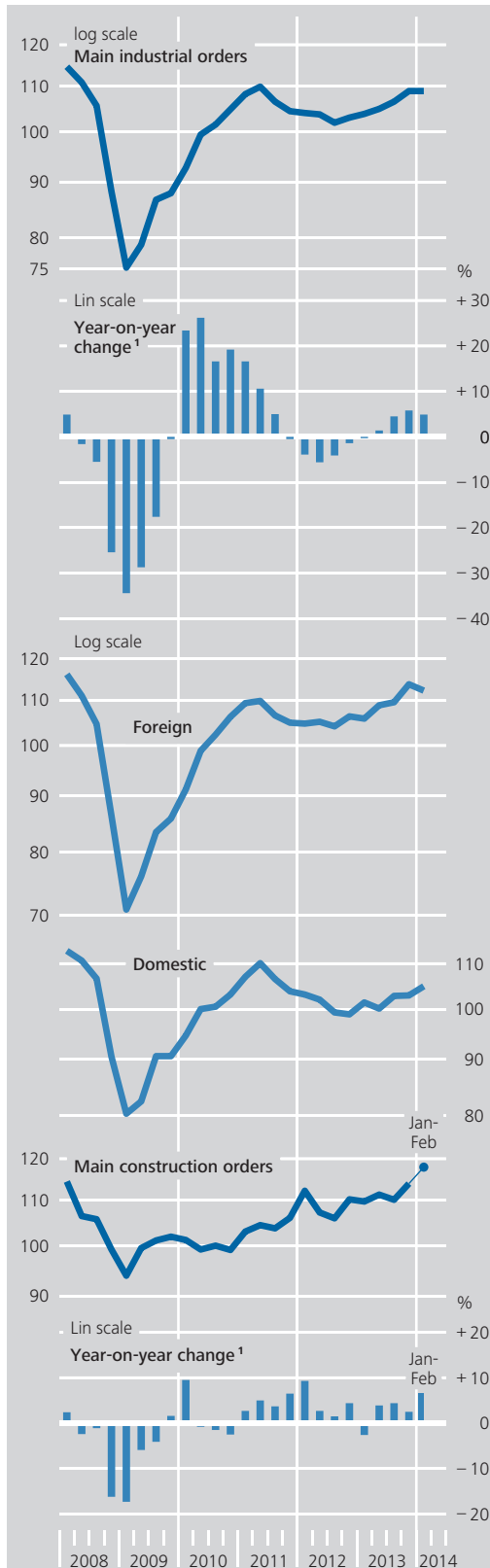
Upswing continues

A stronger domestic component of demand is indicated by the fact that seasonally adjusted domestic industrial orders received increased significantly by 2% in the first quarter of this year, whereas the overall inflow of orders was no higher than in the preceding three-month period. This was not due solely to domestic enterprises ordering more primary and intermediate products (+1%) in anticipation of planned expansions in production. Above all, capital and consumer goods producers also received

More domestic industrial orders, ...

Demand for industrial goods and construction work

Volume, 2010 = 100, seasonally adjusted, quarterly



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

more orders from domestic customers (+2½% and +3¼% respectively). Momentum in the capital goods sector did not stem from the motor vehicle industry, however, and very little came from mechanical engineering. There was, however, a particularly sharp rise in what are generally large-volume orders in the other transport equipment sector.

Seasonally adjusted export orders in the first quarter of 2014 were clearly down on the fourth quarter of last year. This was partly due to the fact that there were fewer large-scale orders for other transport equipment than in the preceding three-month period. Furthermore, since the start of 2014, orders from EMU partner countries were a long way from matching their strongly elevated level in the period from October to December 2013. However, in quarter-on-quarter terms, somewhat more orders were received from non-euro-area countries (+¾%) after seasonal adjustment.

... but fewer export orders

The recently more moderate underlying trend in external demand when compared with domestic orders applies to all the major industrial sectors with the exception of the automotive industry. After the start of the year, motor vehicle manufacturers were again benefiting from the popularity of German makes of car, especially outside Europe. In the EMU partner countries, which are recovering only slowly on the whole, in the first quarter seasonally adjusted demand for German-made intermediate goods was only slightly stronger than in the final quarter of 2014, when there had been a perceptible increase for the first time since the beginning of 2012. In seasonally adjusted terms, orders received for intermediate goods from outside the euro area in the period from January to March failed on average to match their heightened level in the fourth quarter of last year. What is striking is the underlying trend in the German mechanical engineering sector which, for a year now, has been receiving more orders from the rest of the euro area again; in any event, the year-on-year figure was nearly one-tenth up on the low at the beginning of 2013.

External demand for German motor vehicles picking up again

This stands in contrast with non-European export orders for machinery during the same period, which showed an overall decline of 2¾% from the level at that time.

Unbroken upward trend in construction orders

The construction sector enjoyed a further substantial surge in orders at the beginning of the year. One area this affected was housing construction. The upturn in demand is unbroken in this subsector. In January and February 2014, not only were more permits for apartments granted than on an average of the fourth quarter of 2013 after seasonal adjustment (+7¾%), the figure was also somewhat up on the very high number of dwellings approved by the authorities during the summer months of 2013 as part of new building projects. Additionally, at the start of the year enterprises also placed somewhat more orders for construction projects. Major commercial civil engineering pro-

jects are also likely to have been of significance in this context.

The favourable demand conditions in industry and construction correspond to the ongoing improvement in business expectations which the Ifo Institute recently identified for these sectors of the economy. Added to this are rising optimism in retail and other services sectors as well as the more confident sentiment of households. The pick-up in the labour market and the perceptible growth in wages and salaries, which form the basis for the income prospects that consumers rate as very positive, may be seen as additional pointers to a further upturn in domestic activity. The continuing favourable export expectations in manufacturing point to a modestly positive underlying trend in external demand.

Domestic momentum sustained by enterprises' and consumers' optimism