

## Economic conditions in Germany

### Underlying trends

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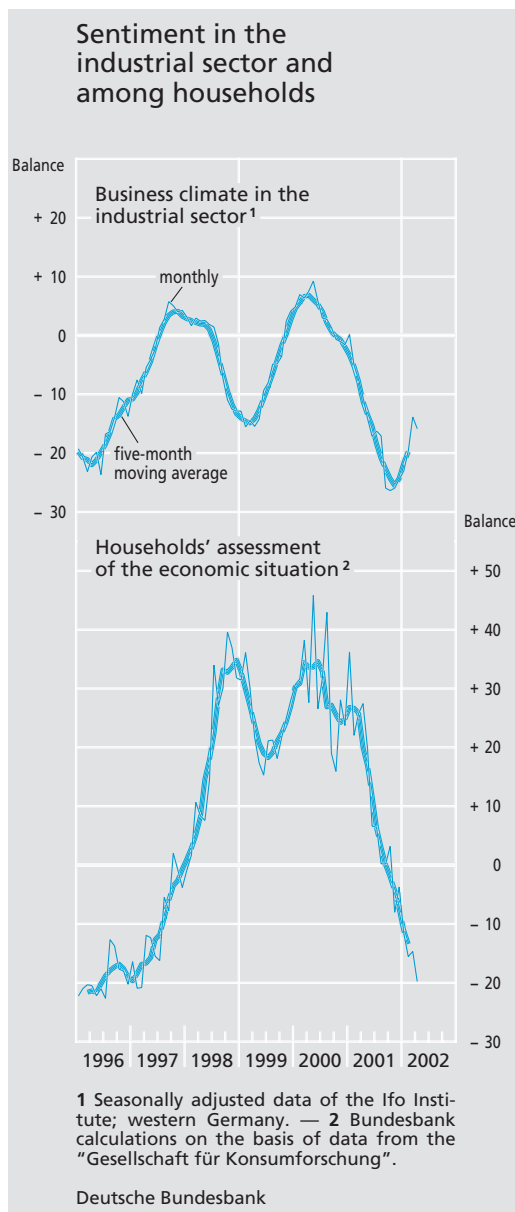
The cyclical slowdown in the German economy, which had been marked by a ¼% decline in real gross domestic product (GDP) during the second half of 2001, did not continue in the first few months of this year. The stabilisation of conditions that was identifiable towards the end of last year led into a period of slight recovery in the first quarter. The upturn was not broad-based, however. Overall capacity utilisation is unlikely to have increased yet. If the economy is moving on no more than a flat and narrow path of growth – as at present – even minor disruptions or downturns in sentiment can have a severe impact. It is not least for that reason that future developments in oil prices and this year's pay negotiations are of particular importance.

*Emergence  
from the  
cyclical trough*

According to the Bundesbank's own provisional calculations, overall output in the first quarter of 2002, after adjustment for seasonal and working-day variations, is likely to have been about ¼% higher than in the final quarter of last year. Having matched the previous year's level in the fourth quarter of 2001, working-day-adjusted output, was, for the first time, slightly down on the year, however. After adjustment for the number of working days (of which there were significantly fewer than in the same period of 2001), there was, in fact, a decline of around 1%.

In the wake of the international cyclical upturn, the main stimuli in the first few months of the year were external. This enabled the German economy to benefit rapidly from the

*Growth still  
on weak  
foundations*



improvement in the global environment – something that was also clearly reflected in an increased intake of foreign orders. The likely first-quarter rise in net exports is mainly an indication of continuing weak domestic demand. This, in turn, put a brake on import activity. Business investment remained very subdued owing to the low utilisation of fixed assets, which affected machinery and equipment as well as buildings. Furthermore, pres-

sure on inventories also persisted in the first quarter. In addition, it was not only with regard to residential construction that households remained very restrained. Major purchases for consumption purposes were also put on hold in many cases. Surveys undertaken by the consumer research institution *Gesellschaft für Konsumforschung* (GfK) indicate that the propensity to purchase remains low. It may be that the various price influences in the first quarter have curbed households' propensity to consume. Also, surveys show that the outlook for incomes is still rated as not especially favourable. The fact that the labour market was feeling the impact of the economic slowdown up to the end of the period under review may have played a part in this.

### Output and labour market

Following its observable decline since spring 2001, industrial output stabilised in the first few months of the current year. Average seasonally adjusted output in the period from January to March was more or less exactly as high as in the fourth quarter of last year. The year-on-year fall, which was somewhat over 4% in autumn 2001, increased to 5¼% – owing, in part, to a base effect.

*Stabilisation of industrial output*

This meant that industrial enterprises' capacity utilisation was down again. According to the ifo surveys, the degree of capacity utilisation in March 2002 – adjusted, as far as possible, for seasonal variations – amounted to 81½% of the standard level. This signified a decline of around 4 percentage points on

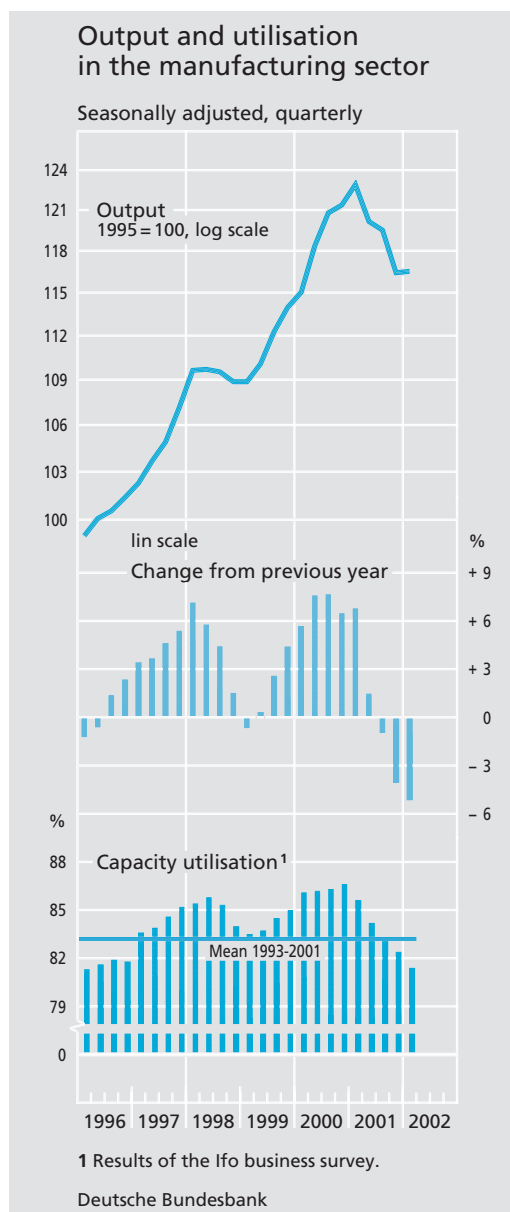
*Declining capacity utilisation*

the year. Compared with the longer-term average, the fall was roughly 2 percentage points.

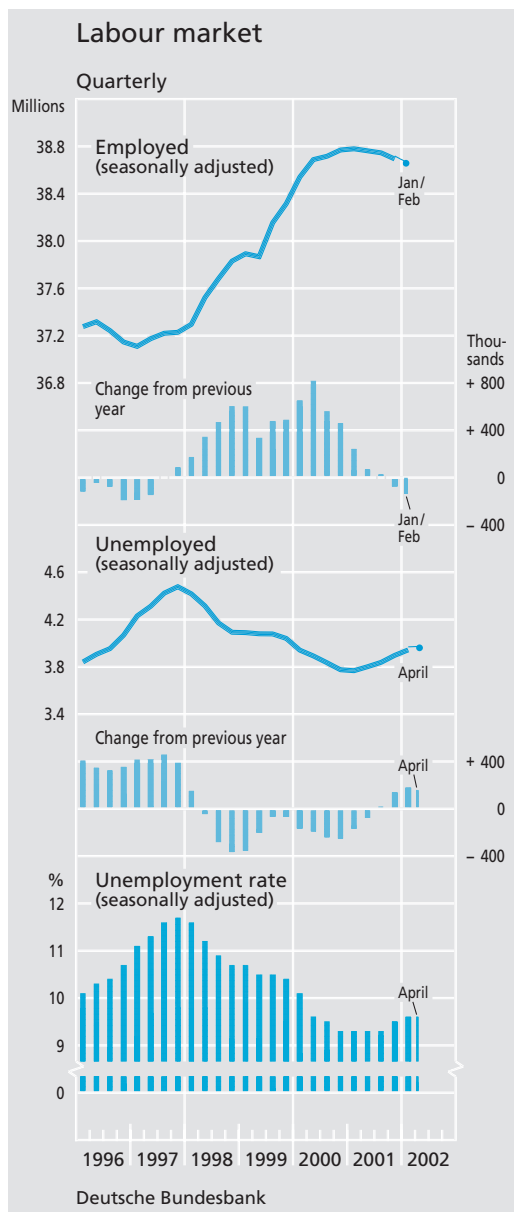
Developments in output varied widely from sector to sector. Intermediate goods, for example, recorded a seasonally adjusted 2% increase in output compared with the lowest point in autumn 2001. The best performance in this sector was by manufacturers of chemicals, chemical products and man-made fibres, whose output grew by almost one-tenth. At 5%, manufacturers of basic metals also attained a notable increase. Producers of consumer goods also performed well. In contrast to this, there was a further slide in capital goods output, with the drop in durable goods output being even more marked. All major branches of the capital goods sector, especially motor vehicles manufacturers, manufacturers of machinery and equipment and the electrical engineering sector, reported a decline in production. Among consumer goods producers, manufacturers of radios and televisions, in particular, suffered sharp falls in output.

*Continuing  
decline in  
employment*

Right up to the present, the situation on the labour market has been marked by a decline in employment and a rise in unemployment. According to Federal Statistical Office data, the seasonally adjusted number of persons in work had fallen to 38.66 million by February. This was around 145,000, or 0.4%, lower than in the comparable period of 2001. In the fourth quarter, the year-on-year decline had been only half as large. The construction sector and, latterly more and more, industry, too, have been cutting back their workforces.



There are likely to have been cuts in staffing levels in some areas of the services sector as well. At the same time, more and more persons have seen their working hours reduced. In April, around 245,000 persons were recorded by the labour exchanges as being on short-time work, being employed, on average, for not quite two-thirds of their normal working hours. The number of persons af-



affected has more than doubled on the year, with the majority coming from industry.

*Stagnation in the recorded number of unemployed*

At the end of April, the number of persons registered as unemployed with the Federal Labour Office amounted to 3.97 million in seasonally adjusted terms. As shown in the statistics, this figure was scarcely higher than in the preceding months. The year-on-year increase, which had been as much as almost

200,000 in January, fell to 155,000. As calculated by the Federal Labour Office, the seasonally adjusted unemployment rate had been 9.6% for the past four months. The corresponding figure in line with international standards was 8.1%.

However, it would be inaccurate to regard this development as already being the start of a cyclical improvement on the labour market. In point of fact, there has also been an “adjustment” in the unemployment statistics recently. The calling into question of the effectiveness of the job placement activities undertaken by the labour exchanges led to intensified efforts in that area. These included the launching of a “job placement offensive” with the help of additional staff, and stepping up the implementation of the measures contained in the *JOB-AQTIV Gesetz* that entered into force at the start of the year. This act (AQTIV stands for “activate, qualify, train, invest, place (*vermitteln*)”) provides for an assessment of each unemployed person’s job prospects and an agreement on getting people back to work that contains a binding individual placement strategy. In addition, unemployed persons are obliged to step up their own efforts to find a job.

*“Adjustment” of the statistics*

The labour exchanges’ calls for greater personal involvement have evidently led to many persons previously registered as unemployed not re-registering or, as older members of the labour force, making use of their right to forgo job placement. Some time ago, in fact, a study conducted by the *Institut für Arbeitsmarkt- und Berufsforschung*, the labour market and employment research institution of

## Problems of matching supply and demand on the labour market

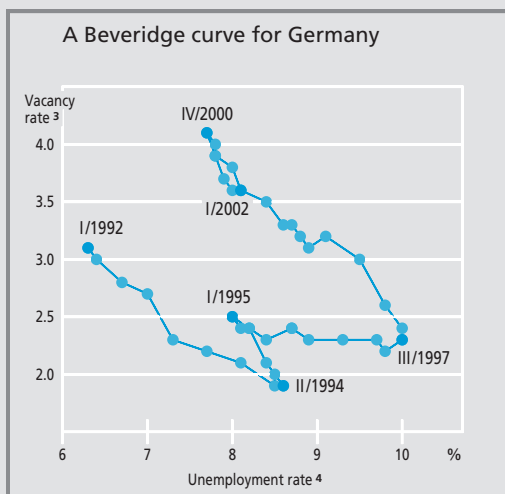
It recently became evident that the official statistics on job placement for unemployed persons had been overstated. This is a serious matter because one of the labour exchanges' most important tasks is to help to create a match between the job seekers registered with them and the demand for labour in the economy.

A recent study produced by the European Central Bank (ECB) in cooperation with the national central banks<sup>1</sup> reveals that difficulties in matching supply and demand on the labour market exist not only in Germany but also in other euro-area countries. Over the last ten years, for example, the Beveridge curve, which shows the relationship between unemployed persons seeking work and vacancies, has shifted significantly outwards. An outward shift of the curve indicates a simultaneous increase in unemployment and vacancies resulting from increasing structural difficulties in the matching process. In Germany, for instance, the number of vacancies increased from just over 1 million in 1992<sup>2</sup> to what is estimated to be around 1.5 million in 2001, while the unemployment figure went up from 2.6 million to 3.1 million during the same period.

The causes of this increasing discrepancy lie on both the supply side and the demand side. The supply side causes include the impact of demographic developments on the structure of the economically active population as reflected in, say, the ageing process and immigration. It also includes changes in the participation rate of men and women. The demand side is affected, among other things, by structural change, which is characterised by a tendency for the services sector to gain ground at the expense of production. Moreover, all these factors occur in specific regional forms which create points where especially heavy imbalances are concentrated.

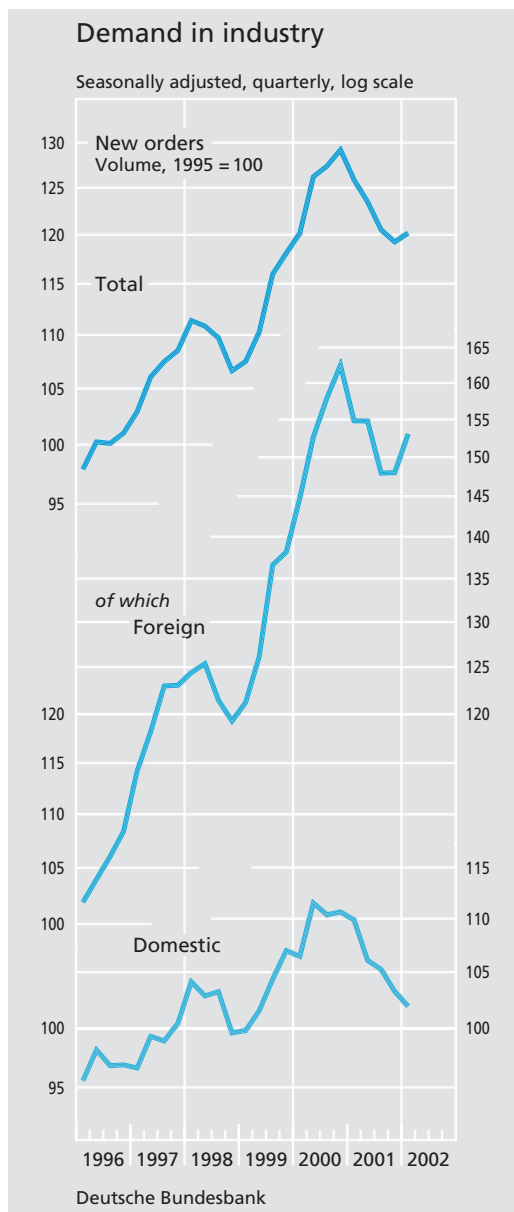
<sup>1</sup> To download this study, entitled "Labour Market Mismatches in Euro Area Countries", go to the Bundesbank's website and then click *English Version, Economics, and Other economic publications*. — <sup>2</sup> The number of vacancies Deutsche Bundesbank

The conclusion drawn by the ECB is that this mismatch can be alleviated, above all, by reducing rigidities on the labour market. This includes, not least, pruning administrative regulations and improving the coordination of tax systems with unemployment benefits. One of the measures open to employers could be to offer more flexible working hours in the form of models tailored to individual requirements. Employees need to take the initiative regarding education, training and learning as well as mobility. Management and labour, which play a crucial role in determining the cost of labour input, have a large degree of responsibility. Official employment services can take on key tasks in improving market transparency - something the individual jobseeker is hardly able to accomplish on a broad scale.



As described in the ECB's analysis, developments on the euro-area labour market in the late 1990s – with rising employment and falling unemployment – were, in fact, clearly positive. However, the density of regulation still appears to be too high, negative incentives too strong and flexibility too low for achieving a thoroughgoing and sustained improvement on the labour market.

has been estimated from the firm surveys of the IAB. — <sup>3</sup> Relative to the number of persons in the workforce; the Bundesbank's own calculations. — <sup>4</sup> ILO definition.



the Federal Labour Office, revealed that almost 30% of persons who are out of work are not seriously interested in a new job. Half of them belonged to the group of older members of the labour force who, in the foreseeable future, will be switching from pre-retirement to becoming recipients of a pension. A further 7% had registered as unemployed in order to secure rights to social benefits. Irrespective of this, it has become

more difficult to match supply and demand on the labour market over the longer term. A recent study undertaken by the European Central Bank in cooperation with the national central banks has shown that this situation applies not only to Germany but also to a number of other euro-area countries (see notes on page 50):

### Orders received

Demand for German industrial goods picked up slightly at the start of 2002. Although incoming orders in the first few months of the year did not match their level in December, new orders in that month had been inflated by backlog effects. Orders that had initially been put on hold in the wake of the 11 September terrorist attacks were placed as the global economy increasingly regained its footing. In order to characterise the cyclical trend, it is therefore useful to compare the first few months of the current year with the final quarter of 2001 as a whole. In seasonally adjusted terms, orders received in the January to March period were around ¾% up on the fourth quarter of last year. This represented a marked decline on the year, although – at 4½% – it was not as pronounced as in the final months of 2001, when a figure of almost -8% had represented a new low.

*Improvement  
in the orders  
situation  
in industry*

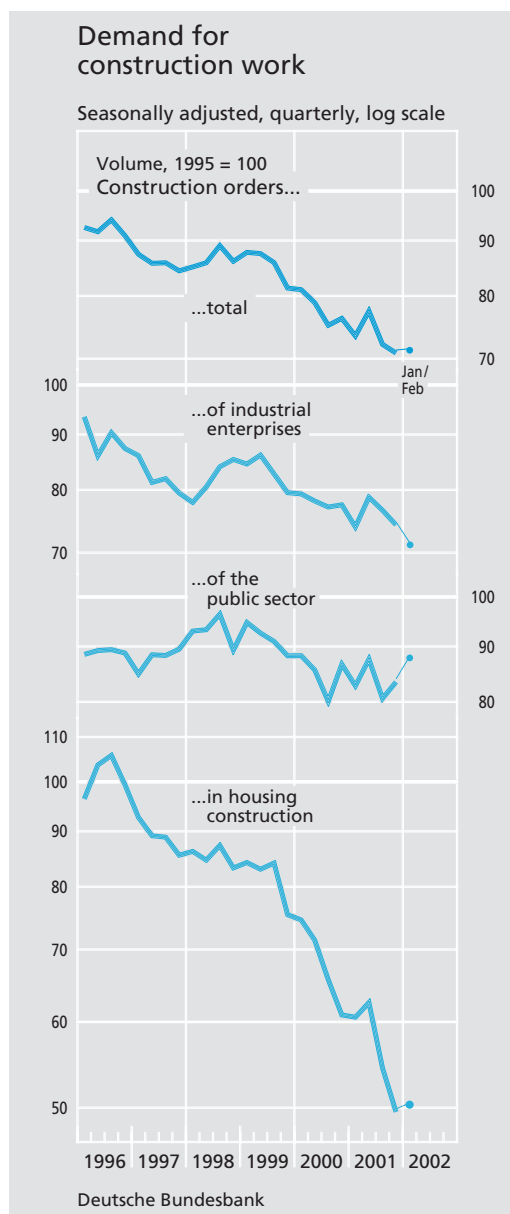
Up to that point, the slight improvement in incoming orders had been sustained solely by foreign demand. In seasonally adjusted terms, orders from abroad in the first three months were 3½% up on their level in autumn last year. They were only 1% down on

the year, compared with -9% in the fourth quarter of 2001. Intermediate goods were in particular demand, but capital goods and consumer goods also performed well.

Domestic demand early in the year failed to match autumn levels, however, and, at 7¼%, the year-on-year decline was, in fact, somewhat greater than before. It was only in intermediate goods that orders picked up slightly. By contrast, consumer goods and capital goods producers both suffered a further decline in orders.

*Construction orders remain unfavourable*

Construction orders continued to be very subdued at the start of 2002. New construction orders reported in the January-February period were scarcely up on the low level of the autumn months in seasonally adjusted terms. The level was almost 5% down on the comparable period at the start of 2001. Although this decline was not quite as large as towards the end of last year, when it had been more than 7%, it has to be borne in mind, however, that orders have been declining now for several years. Industry, in particular, has cut back its construction projects again recently. Following a seasonally adjusted decline of around 4½% compared with the final quarter of 2001, orders in January and February fell to their lowest level since the early nineties, when statistics for the whole of Germany began. By contrast, in the first two months of this year, public sector clients placed significantly more construction orders than they did towards the end of last year. There was also a slight increase in year-on-year terms. This development is hardly likely to be sustained, however, since the cen-



tral, regional and local authorities remain in a tight financial situation. The amount of incoming orders in residential construction at the start of the year largely held steady at their autumn level, which was no more than half as high as in 1995. The construction permits granted in January and February do indicate an upturn in demand, however.

## Prices

*Price  
developments  
and price  
sentiment*

The price climate has become calmer again of late. This followed a perceptible deterioration early in the year caused mainly by further tax increases and weather-induced shortages of some food products. Four-fifths of the sharp price rise at the start of 2001 can be traced to those factors, whereas the changeover from the D-Mark to the euro in cash payments had scarcely any impact in terms of pushing up prices.<sup>1</sup> While it is true that the prices of many everyday goods and services in frequent demand did go up noticeably in many cases, this – contrary to popular opinion – had little effect on the overall consumer price level as measured by the consumer price index. This is due to the fact that the price rises which were repeatedly cited by the general public and which had a perceptible impact on price sentiment among many consumers – such rises took place, for example, in selected services provided by the hotel and catering industry and by some craft trades – make up only a relatively small part of the overall basket of goods. This basket comprises the important area of rents, for instance, which are included in the basket with a 20% weighting, as well as consumer durables, such as cars, furniture and household electrical appliances. In these cases, however, the euro prices were largely derived exactly from the earlier D-Mark prices. In some cases prices were even reduced. This is likely to have received less attention in many quarters, most notably because such purchases are made only at fairly long intervals. Furthermore, people are probably generally more aware of price rises than they are of falling

prices. The impression that prices are going up is also encouraged by the fact that prices are often converted from euro into D-Mark using the 1:2 “rule of thumb”. This is intended to allow an easy comparison with traditional D-Mark prices but, seeing as the “real” conversion factor is 1:1.955583, the resulting figure is too high.

According to the official statistics, consumer prices went up by 0.5% between January and April in seasonally adjusted terms, corresponding to an annual rate of 1.8%. Lower prices, especially for seasonal foods, were offset by rising prices for refined oil products. The year-on-year rate of price increase, which is generally regarded as a yardstick of inflation, went down from 2.1% in January to 1.6% in April. Base effects in the case of food played a part in this, since BSE and foot-and-mouth disease as well as unfavourable weather conditions had led to a marked increase in food prices last year. Excluding food products, the year-on-year rate of increase, at 1.5%, was comparatively stable.

*Slower rate of  
price increase*

That was mainly due to the fact that the year-on-year rate of price increase for both industrial goods and housing rents remained largely unchanged. In April, industrial goods were up 1.5% on the year, and housing rents were 1.4% higher than one year before. At 2.0% in April, the year-on-year rate of price increase for services was only a little slower than at the start of the year, when the figure had been 2.2%. Energy cost somewhat more in April 2002 than in April 2001. The principal

<sup>1</sup> See Deutsche Bundesbank, *Monthly Report*, March 2002, p 8ff.



reason for this was a further sharp rise in prices for refined oil products, which offset the decline that had been recorded since summer 2001.

*Oil prices higher*

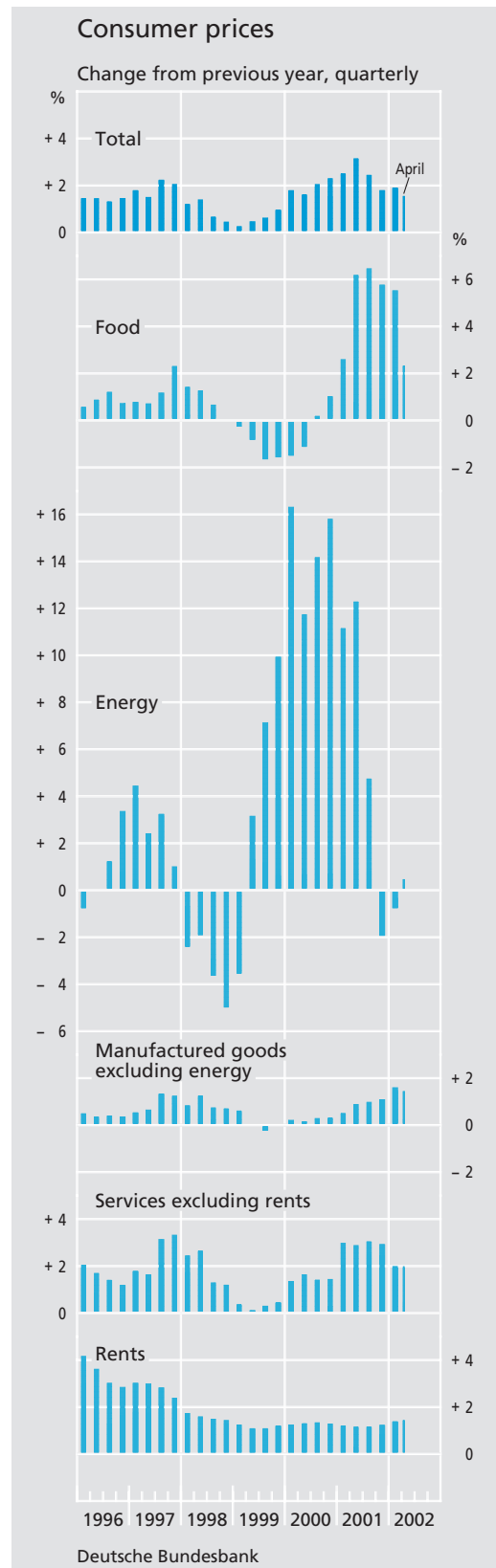
International oil prices, which had fallen to just under US\$19 per barrel of North Sea Brent in mid-January, were at more than US\$26 in the last few weeks of the period under review. In early April, they even peaked at US\$27¼ for a time. This price rise – driven partly by speculation – was mainly due to fears of increased political tension in the Middle East which threatened to impede the supply from the producing countries in that region. On the demand side, the exceptionally mild weather conditions have more than compensated for the gradually rising cyclical needs.

*More expensive imports*

The rising prices for crude oil and refined oil products have also made German imports as a whole significantly more expensive. Measured by the import price index, the level in December, which marks the most recent low, was overshoot in March by a seasonally adjusted 1¾%. The year-on-year decline went down to 2.5%, compared with 4.7% at the end of 2001. This was partly due to the fact that the onset of winter weather in the first few months of the current year had led for a time to sharp increases in the prices of agricultural products. Excluding these influences, prices remained largely constant, with the year-on-year fall amounting to 2¼% in both December and March.

*Increase in industrial producer prices*

The oil factor was also reflected in domestic industrial prices. The seasonally adjusted rise recorded in the course of the year so far was



due solely to higher energy prices. The price level did show a 0.2% decline on the year in March but this was largely due to a sharp fall in the price of some intermediate goods. This offset the continued rise in the cost of capital and consumer goods, which amounted to 1.6% and 1.0%, respectively, year on year.

*Stagnation in  
construction  
prices*

Given the continuing structural difficulties in the construction sector, there was scarcely

any increase in the cost of construction work up to the end of the period under review. Construction prices in the first quarter of 2002 were more or less at exactly the same level as one year before. Slight price increases were identifiable only in the case of maintenance work in the housing sector. This contrasted with price reductions for shell construction work.