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Economic Turnaround in Austria, Momentum Still Weak

Business Cycle Report of September 2013

While economic developments outside Europe have been quite diverse, signs are mounting in the EU that the recession is ending. In Austria, business surveys and WIFO's Leading Indicator also suggest an improvement in economic conditions in the near future; up to now stimulus to growth is weak, however.

For definitions of terms used, see "Methodological Notes and Short Glossary", <http://www.wifo.ac.at/wwadocs/form/WIFO-BusinessCycleInformation-Glossary.pdf> • All staff members of the Austrian Institute of Economic Research contribute to the Business Cycle Report. • Data processing: Christine Kaufmann, Martha Steiner • Cut-off date: 6 September 2013. • E-mail address: Marcus.Scheiblecker@wifo.ac.at

WIFO's latest Business Cycle Survey conducted on behalf of the European Commission shows that firms' expectations concerning future business conditions have improved. Present developments are also being assessed more positively than recently. WIFO's Leading Indicator increased significantly in August following five months of stagnation; the majority of components rose noticeably compared with previous months.

The surveys for Germany show a similar picture: the Ifo Business Climate Index has continued its upward trend in recent months, with firms assessing both their business conditions and expectations for the future more positively than lately.

By contrast, the economies of emerging market countries, until recently the drivers of the expansion of the global economy, have clearly lost momentum. In China, growth has been decelerating considerably since 2010, and the situation has been similar in India, Brazil and Russia. By contrast, economic activity remains buoyant in the USA and has accelerated in Japan owing to extensive economic stimulus measures.

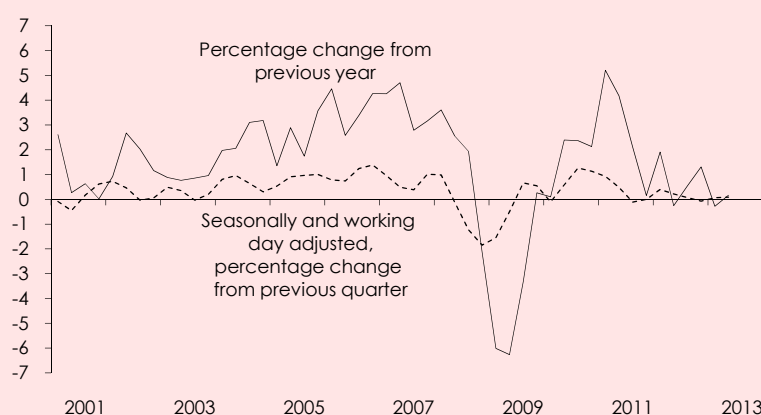
The lower turning point of the business cycle appears to have been reached also in Europe. In the second quarter, the euro area economy grew again for the first time in almost two years (+0.3 percent, compared with the previous quarter). This was largely due to developments in Germany (+0.7 percent) and France (+0.5 percent), while the decline in Spain and Italy slowed considerably. Extremely vigorous growth was recorded for Portugal's economy following a long-lasting recession (+1.1 percent).

In August, the European Commission's Economic Sentiment Indicator increased significantly by 2.7 points to 95.2 in the euro area and by 3.1 points to 98.1 in the EU as a whole. Hence it remained only little below the threshold of 100 points, which represents the long-run average. The improvement was broad-based – the largest economies such as Germany, France, Italy and Spain recorded a sharp increase. But the financial market crisis in the EU has not yet been overcome: many banks are still in a difficult situation, and in a number of countries structural problems continue to be a major strain on the economy. Besides, the appreciation of the euro vis-à-vis many major currencies may subsequently dampen exports.

The Austrian economy also appears to have passed the lower turning point of the business cycle; GDP rose again by 0.1 percent quarter-on-quarter in the second

quarter. While the stimulating forces are still weak, firms' assessments of future prospects given in surveys have become more optimistic.

Figure 1: Growth of real GDP



Source: WIFO.

Table 1: Quarterly national accounts

	Percentage changes from previous quarter							
	First quarter	Second quarter	Third quarter	Fourth quarter	First quarter	Second quarter		
<i>Adjusted for seasonal and working day effects, volume</i>								
Final consumption expenditure	+ 0.1	- 0.0	- 0.3	- 0.1	+ 0.1	+ 0.1		
Households ¹	+ 0.1	- 0.0	- 0.1	- 0.1	- 0.1	- 0.0		
General government	- 0.1	- 0.1	- 0.0	+ 0.2	+ 0.4	+ 0.3		
Cross capital formation	- 0.3	- 0.5	- 0.6	- 1.0	- 1.3	- 0.8		
Gross fixed capital formation	+ 0.3	- 0.0	- 0.4	- 0.9	- 1.2	- 0.9		
Machinery and equipment	+ 0.8	- 0.6	- 1.8	- 1.8	- 1.7	- 1.3		
Construction	+ 0.6	+ 0.7	+ 0.7	+ 0.2	- 0.4	- 0.1		
Exports, goods and services	- 0.1	+ 0.7	+ 0.7	+ 0.1	+ 0.3	+ 0.3		
Goods	- 0.6	+ 0.9	+ 0.7	- 0.8	+ 0.1	+ 0.2		
Services	+ 0.9	+ 1.0	+ 1.0	+ 1.0	+ 0.7	+ 0.6		
Imports, goods and services	- 0.3	- 0.2	- 0.2	- 0.3	- 0.4	- 0.1		
Goods	- 1.0	- 0.2	+ 0.1	- 0.5	- 0.2	+ 0.1		
Services	+ 1.5	+ 0.9	+ 0.0	+ 0.4	- 0.5	- 0.4		
Gross domestic product	+ 0.4	+ 0.2	+ 0.1	- 0.1	+ 0.1	+ 0.1		
Manufacturing	+ 1.1	+ 0.3	- 0.7	- 0.6	- 0.0	+ 0.2		
	2011	2012	2012				2013	
			First quarter	Second quarter	Third quarter	Fourth quarter	First quarter	Second quarter
<i>Volume, chained prices</i>			Percentage changes from previous year					
Final consumption expenditure	+ 0.7	+ 0.4	+ 2.5	+ 0.5	- 0.3	- 0.8	- 0.7	- 0.9
Households ¹	+ 0.8	+ 0.5	+ 2.5	+ 0.8	+ 0.1	- 1.1	- 1.2	- 1.4
General government	+ 0.3	+ 0.2	+ 2.5	- 0.5	- 1.5	+ 0.2	+ 0.6	+ 0.8
Cross capital formation	+ 12.2	- 1.2	- 3.7	- 4.0	- 3.8	+ 7.1	- 12.5	- 4.4
Gross fixed capital formation	+ 8.5	+ 1.6	+ 3.8	+ 2.7	+ 0.7	- 0.1	- 4.0	- 4.4
Machinery and equipment	+ 14.3	+ 2.1	+ 8.9	+ 6.7	- 4.1	- 2.1	- 8.5	- 11.5
Construction	+ 2.5	+ 2.5	+ 1.1	+ 1.7	+ 5.4	+ 1.4	+ 0.6	+ 0.3
Exports, goods and services	+ 6.6	+ 1.2	+ 1.8	+ 0.7	+ 2.0	+ 0.4	+ 2.1	+ 3.9
Goods	+ 8.1	+ 0.4	+ 1.6	- 0.4	+ 1.0	- 0.4	+ 0.5	+ 4.1
Services	+ 2.8	+ 3.3	+ 2.0	+ 4.2	+ 4.7	+ 2.5	+ 5.4	+ 3.4
Imports, goods and services	+ 7.6	- 0.3	+ 0.6	+ 0.2	- 1.7	- 0.2	- 2.1	+ 1.0
Goods	+ 8.6	- 1.4	- 0.3	- 1.6	- 2.4	- 1.4	- 2.2	+ 2.0
Services	+ 3.8	+ 4.5	+ 4.5	+ 7.7	+ 1.2	+ 5.3	- 1.6	- 2.8
Gross domestic product	+ 2.8	+ 0.9	+ 1.9	- 0.3	+ 0.5	+ 1.3	- 0.3	+ 0.2
Manufacturing	+ 8.3	+ 1.2	+ 3.0	+ 0.1	+ 0.9	+ 0.8	- 1.9	+ 0.7
<i>Gross domestic product, value</i>	+ 4.9	+ 2.6	+ 3.3	+ 1.1	+ 2.4	+ 3.6	+ 1.8	+ 2.0

Source: WIFO. -¹ Including private non-profit institutions serving households.

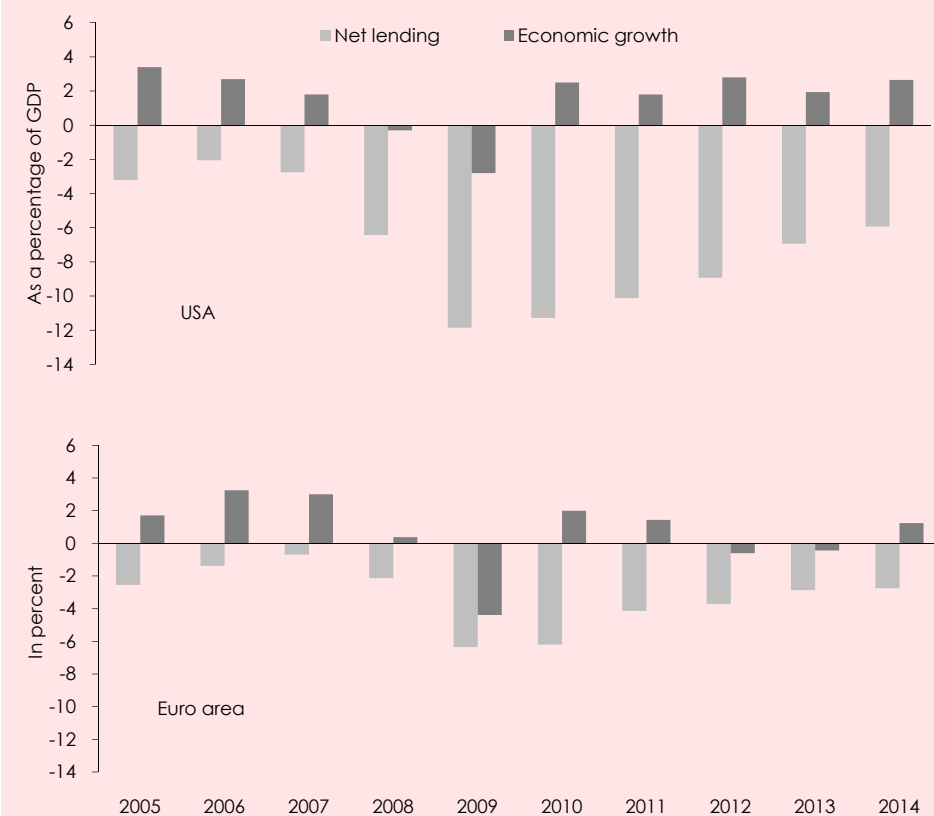
In the USA, the very expansionary economic policy followed until recently, contributed to a quick return to robust growth. The Federal Reserve Board has kept the key interest rate at almost 0 percent already since the end of 2008. The extensive purchase of government bonds led to an increase in bond prices, thereby reducing the government's interest load, but also that of private households, whose demand for real estate has again recovered in the last one and a half years. House prices have risen as a result, i.e., the collateralisation basis for mortgage loans has again gained in value. This stabilises the US banking system, which was badly hit by the crisis.

Fiscal policy during the economic crisis was also much more expansionary in the USA than in the euro area. In 2009, US net borrowing was almost 12 percent of GDP (euro area 6.4 percent), which was only slowly reduced in subsequent years. In 2013, net borrowing is to fall by 2 percentage points, from around 9 percent to 7 percent of GDP. A reduction of this magnitude was recorded in the euro area already in 2011. As economic growth in the USA is already relatively robust, and most of the consolidation effort is taking place on the revenue side, this cut should barely weigh on the economy this year.

US economy robust despite budget consolidation

Following a period of weakness in the fourth quarter of 2012, US GDP rose by 0.3 percent in the first quarter of 2013 and 0.6 percent in the second quarter. Economic activity is not expected to slow, according to leading indicators, although a markedly more restrictive government budget has been set. This may possibly be due to waiting longer than in the EU before implementing fiscal consolidation measures.

Figure 2: General government financial balance and economic growth



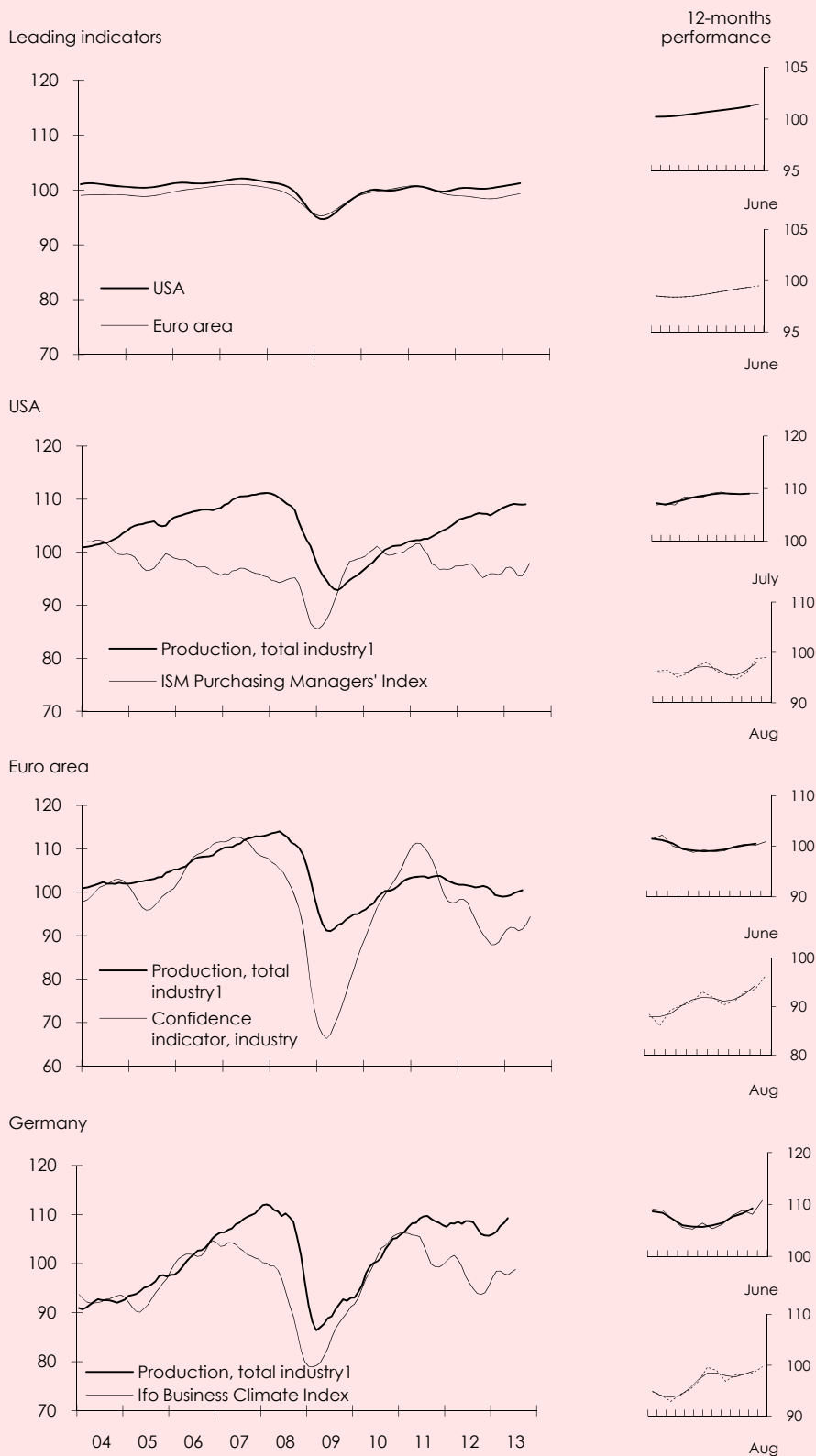
Q: OECD, European Commission. 2013, 2014: forecast.

In the second quarter, the pace of economic growth accelerated to +0.6 percent, from +0.3 percent in the previous quarter. Construction investment posted a particularly sharp increase (both residential and non-residential construction more than +3 percent), whereas equipment investment rose barely at all (+0.7 percent). Personal consumption expenditure, while rising by a mere 0.4 percent, nevertheless continued its previously robust growth observed since the beginning of 2010.

The situation in the labour market, so far the main argument for the still expansionary economic policy, also improved steadily. After the economic crisis the unemployment rate had fallen at an unusually slow pace (October 2009: 10 percent, August 2012: 8.1 percent, July 2013: 7.4 percent). In an economic boom rates of around 4.5 percent are possible.

Figure 3: International business climate

Seasonally adjusted, 2010 = 100, 3-month moving average



Source: European Commission, Deutsche Bundesbank, ISM (Institute for Supply Management™), Ifo (Institute for Economic Research, Munich), OECD. – 1 Excluding construction.

Signs of economic growth have recently begun to emerge also in Japan. The extremely expansionary monetary policy implemented recently to combat persistent deflation drove up stock prices and caused a sharp depreciation of the yen (vis-à-

vis the euro around –30 percent compared with last year, vis-à-vis the US dollar –25 percent). Having overcome the recession in 2012, Japan's economy has been expanding again since the fourth quarter of 2012. Private consumption has played an important role in the process. The business survey from June suggests a favourable economic environment going forward. Therefore Japan's economy is expected to continue on a growth path also in the third quarter.

Registering above-average growth and gaining in importance for the global economy, the heterogeneous group of BRIC countries – Brazil, Russia, India and China – has been driving the expansion of the global economy in recent years. Economic activity in these countries remained robust also during the 2008-09 recession.

Now the economic momentum in these countries appears to be increasingly cooling. In Brazil, economic growth dropped below 1 percent in 2012, the exchange rate vis-à-vis the US dollar and the euro has declined by around 15 percent since the beginning of the year. But the strain on domestic demand caused by rising interest rates owing to the capital outflow is stronger than this positive effect on exports. Economic growth is therefore set to be moderate in 2013.

Russia's economic situation is determined by stagnating crude oil prices (with great significance for the country's foreign exchange proceeds) and industrial production (January to June 0.0 percent in real terms). Since the beginning of the year, the rouble has lost around 10 percent of its value against the US dollar and the euro.

Similarly, the exchange rate of the Indian rupee vis-à-vis the US dollar and the euro in August 2013 fell to its lowest level ever. Since the beginning of the year the currency has lost around 15 percent of its value against both the US dollar and the euro. In 2012, economic growth dropped by half to stand at 3.8 percent, after +7.7 percent in the previous year (first half of 2013 +2.7 percent, year-on-year).

In China, the expansion has also slowed noticeably. While growth rates before 2012 had always exceeded 9 percent, the central government, set its growth target at 7.5 percent at a much lower level than in the past. On a year-on-year basis, the pace of growth moderated from 7.9 percent in the fourth quarter of 2012 to 7.7 percent in the first quarter and 7.5 percent in the second quarter of 2013. On a quarter-on-quarter basis, the growth rate fell from 1.9 percent to 1.6 percent and 1.7 percent, respectively.

Emerging market economies confronted by weak growth and currency turbulence

The emerging market economies, in recent years the drivers of the global economy, have clearly lost momentum. The reflux of financial capital to the countries of origin is putting the currencies of emerging markets under considerable pressure.

Table 2: Gross Domestic Product, in volume

	2012		2013	
	Third quarter	Fourth quarter	First quarter	Second quarter
	Adjusted for seasonal and working day effects, percentage changes from previous quarter			
EU 28	+ 0.1	– 0.4	± 0.0	+ 0.4
Euro area	– 0.1	– 0.5	– 0.2	+ 0.3
Germany	+ 0.2	– 0.5	± 0.0	+ 0.7
France	+ 0.2	– 0.2	– 0.2	+ 0.5
Italy	– 0.3	– 0.9	– 0.6	– 0.2
Spain	– 0.4	– 0.8	– 0.4	– 0.1
The Netherlands	– 0.9	– 0.6	– 0.4	– 0.2

Q: Eurostat.

In the second quarter of 2013, the euro area economy grew again for the first time in almost two years (+0.3 percent in real terms, quarter-on-quarter). While the peripheral economies are confronted with considerable structural problems, export-oriented economies as for instance in Germany and Austria performed well. Following a slowdown from 2012 onwards (fourth quarter of 2012 –0.5 percent in real terms, quarter-on-quarter, first quarter of 2013 ±0.0 percent), a sharp increase was recorded in Germany in the second quarter (+0.7 percent).

The situation in the euro area has gradually improved since the beginning of the year also without counting Germany, whose economy is more likely to follow non-

Companies in euro area more confident

European business cycles owing to its tight trade linkages: GDP contraction slowed from –0.5 percent in real terms in the fourth quarter of 2012 to –0.3 percent at the beginning of 2013, and was followed by a slight increase of 0.1 percent in the second quarter. All large euro area economies have shown an upward tendency since the fourth quarter of 2012.

Business surveys suggest that the recovery will continue in the euro area and in the EU as a whole. The European Commission's Economic Sentiment Indicator shows persistent improvement for both economic regions. It rose significantly in August, but at 95.2 points in the euro area and 98.1 points in the EU as a whole still remained below the growth threshold of 100. Future prospects brightened considerably both in industry and in the services sector. Consumer confidence also increased.

Industrial production in the euro area has been on an upward trend since the beginning of 2013, which is limited exclusively to Germany, though.

Financial markets have seen the demand for government bonds strengthen further. In Ireland, Spain and Italy, long-term interest rates on 10-year government bonds have returned to levels similar to those registered in 2007 and 2008. They still remain considerably higher in Greece, Portugal and Slovenia.

Labour market conditions in the EU have not deteriorated further in recent months. The seasonally adjusted unemployment rate remains high in both the euro area and the EU (EU 11.0 percent, euro area 12.1 percent).

Euro area inflation is below 2 percent, the target set by the ECB as being consistent with price stability. The rate remained unchanged at 1.6 percent in July and is likely to have dropped to 1.3 percent in August, according to a flash estimate by Eurostat.

According to the quarterly national accounts for Austria, real GDP expanded by 0.1 percent quarter-on-quarter in both the first quarter and the second quarter. On a year-on-year basis, GDP declined by 0.3 percent in the first quarter and grew by 0.2 percent in the second quarter (partly owing to the leap day in 2012). GDP thus contracted by 0.1 percent in the first half of the year.

Austria's economy currently suffers especially from the weakness of domestic demand. Household consumption has no longer been growing already for one year (first quarter of 2013 –0.1 percent, second quarter 0.0 percent, compared with the previous quarter). In the second quarter, firms' weak economic expectations were reflected in a decline in the demand for equipment investment, the pace of which is decelerating, though (first quarter of 2013 –1.2 percent, second quarter of 2013 –0.9 percent, compared with the previous quarter).

The only stimulus worth mentioning in 2013 so far has been provided by net exports. Exports did post extremely weak growth at +0.3 percent in both the first and the second quarter; but imports shrank owing to the stagnation of private consumption and the decline in investment demand, resulting in an increase in net exports.

Since the crisis, the Austrian economy has been performing substantially better than the economy in the euro area as a whole: while the latter shrank markedly over a period of a year and a half, a slight decline was recorded in Austria only in the fourth quarter of 2012 (–0.1 percent). This lead in growth should be maintained, although business surveys suggest that for the nearest future the revival will be weaker than in the euro area as a whole. The Industrial Confidence Indicator, for instance, in the euro area improved by 5.8 points, from its low in April 2013 (–13.7 points) to –7.9 points in August, in Germany by 7 points (to –3.7 points), but in Austria by a mere 3.1 points (to –8.3 points). In the other large euro area economies it still did not exceed the –10 mark.

The working day adjusted industrial production index dropped by 0.1 percent in the first half of the year; in June 2013 it was 1.0 percent below the year-earlier level, and 0.4 percent below the level reached a month before (seasonally adjusted).

In the second quarter of 2013, the euro area for the first time in almost two years registered growth again, driven by Germany as well as France. Companies are now more confident about future business developments. The crisis should thus be a thing of the past. However, structural problems will continue to weigh on economic activity.

Forces stimulating the economy still weak in Austria

Despite registering slight quarter-on-quarter growth, aggregate output declined in the first half of the year compared with the same period a year before. Firms still assess future business prospects only somewhat better. However, the WIFO Leading Indicator points to increasing momentum from August.

The improvement in sentiment indicated by business surveys is less pronounced in Austria than in the euro area as a whole.

According to the quarterly national accounts, construction investment declined in the first quarter of 2013 (-0.4 percent in real terms compared with the previous quarter) and remained flat in the second quarter. The low dynamism of production in this sector is reflected in employment developments: in the first quarter, the number of persons employed was 1.8 percent lower than a year before, while in the second quarter it rose slightly by 0.3 percent.

Construction activity subdued

Construction demand was weak in the first half of 2013 and is not expected by companies to strengthen.

Figure 4: Results from the WIFO Business Cycle Survey

Indices of the assessment of the current economic situation and of business expectations, seasonally adjusted



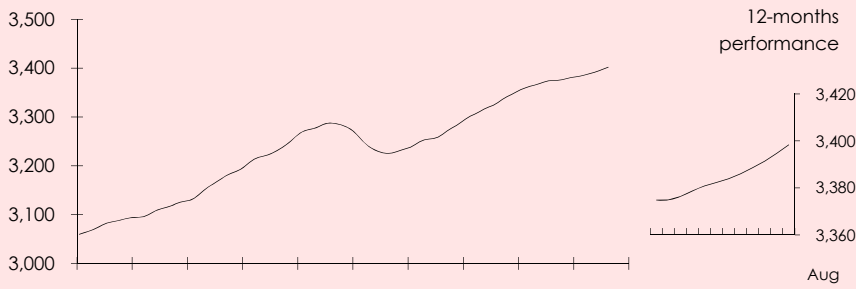
Source: WIFO Business Cycle Survey. Data refer to index points (percentage points) between +100 and -100. Values above 0 imply positive expectations, values below 0 indicate negative expectations.

Weak construction activity considerably dampened construction price developments. Construction price inflation, which in 2012 had without exception exceeded 2.4 percent, slowed to 1.7 percent in the first quarter of 2013 and 1.3 percent in the second quarter. Prices in the civil engineering sector were lower than last year.

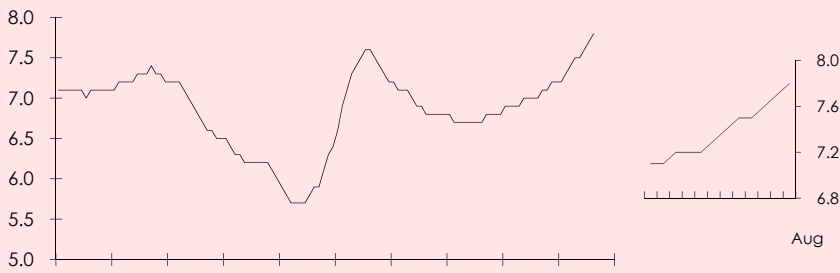
The situation in the construction industry should improve from mid-2013. In the WIFO Business Cycle Survey from August, the majority of construction companies assessed their current level of overall order books as being at least sufficient. Construction employment grew by 1.3 percent year-on-year in July. Demand expectations for the time lying still further ahead are predominantly pessimistic, however. In spite of weak business conditions, companies expect prices to increase again and employment to decline.

Figure 5: Key economic indicators

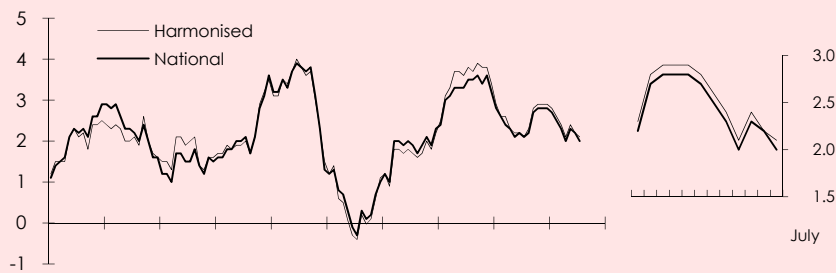
Persons in active dependent employment¹, (1,000), seasonally adjusted



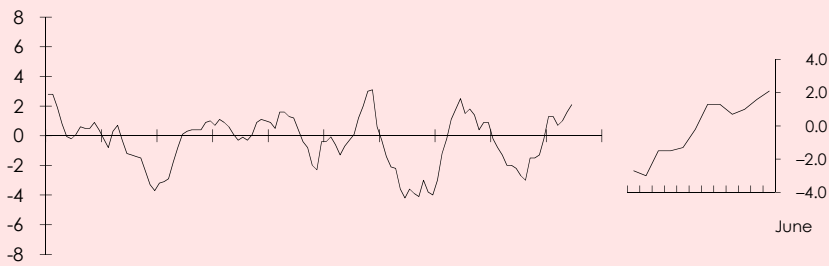
Unemployment rate, traditional Austrian method², seasonally adjusted



Consumer prices, year-to-year percentage changes



Real effective exchange rate, year-to-year percentage changes



10-year central government bonds (benchmark), percent



Source: Public Employment Service Austria, Federation of Austrian Social Security Institutions, Oesterreichische Nationalbank, Statistics Austria, WIFO calculations. – ¹ Excluding parental leave, military service, and unemployed persons in training. – ² As a percentage of total labour force excluding self employed, according to Public Employment Service.

In recent months, consumer confidence in Austria (as measured by the European Commission's Consumer Confidence Indicator) moved in the opposite direction from the improvement at EU level and in Germany. This downward movement ended with the survey in August, when the consumer confidence indicator rose for the first time since March 2013. The balance between positive and negative assessments increased by close to 7 percentage points from the previous month, with all components contributing (e.g., appraisal of the future general economic situation over the next 12 months, assessment of the future labour market situation). The brightening of sentiment among consumers suggests that their willingness to purchase consumer durables, which is highly sensitive to cyclical developments and substantially influences the dynamism of overall personal consumption expenditure, is getting off the ground.

Sales remained subdued also in the second quarter of 2013. On a cumulative basis, some major year-on-year declines in real sales were registered by the retail sector (excluding cars) as well as by wholesalers and car dealers in the first half of the year. Retail sales again exceeded their year-earlier level in both nominal and real terms (working day adjusted) as late as July, according to provisional estimates by Statistics Austria. This development was largely driven by the sharp increase in the food sector, while some of the other sectors saw sales decline in real terms in July. WIFO's Business Cycle Survey for the retail sector conducted in August points to a slight improvement in sentiment, which is apparent in the assessment of both the current and the future business situation.

In the first three months of the summer season (May to July), tourism establishments reported 9.7 million arrivals, a new peak. The number of overnight stays also rose, albeit less sharply, as the length of stay per guest became shorter. Compared with the same period a year before, the number of nights spent increased by 0.3 percent to 31.4 million, with foreign guests accounting for 21.3 million of this amount.

At the same time earnings remained 1.4 percent below the level reached the previous year (in real terms). The better hotel categories (5 stars and 4 stars +1.2 percent) did register an increase at the cost of plainer accommodations (2 stars and 1 star -3.8 percent), but this was accompanied by a pick-up in the demand for commercial and private holiday apartments and homes. The possibility of self-catering connected with it contributed to a decline in the average expenditure per night (-1.7 percent) and dampened the earnings of the tourism industry.

In the international source markets of importance to Austria, the demand from guests from Russia (overnight stays +12.8 percent) and the UK (+10.6 percent) grew at a particularly brisk pace; similarly marked growth was seen in the demand from guests from Sweden (+6.5 percent), Poland (+5.7 percent), Hungary (+5.2 percent), the USA (+4.7 percent), Denmark (+2.5 percent) and the Czech Republic (+1.8 percent). However, the source countries with above-average growth rates accounted for only around 9 percent of the overall demand or 13 percent of overnight stays by foreign guests. Developments of nights spent by guests from Belgium (+0.5 percent) and Germany (+0.1 percent) were more or less in line with the average demand for overnight stays registered globally, while the demand from Romania (-0.3 percent) and France (-0.4 percent) was slightly lower. From May to July 2013, travellers from Switzerland (-1.4 percent), the Netherlands (-2.5 percent) and Italy (-4.3 percent) spent considerably fewer nights in Austria than last year. Styria, Tyrol, Vienna, Burgenland and Vorarlberg posted substantial sales gains, while earnings in the other federal provinces (notably Lower and Upper Austria) declined.

Inflation in Austria is receding further. On the one hand, owing to weak economic activity, cost-raising price surges fail to occur in international commodity markets, and, on the other hand, under-utilisation of capacity barely allows an increase in final product prices, given the weakness of demand. In July 2013, inflation in Austria fell to 2 percent, after declining from 2.3 percent to 2.2 percent in June.

Consumption and trade remain weak

Tourism: good start of the summer season

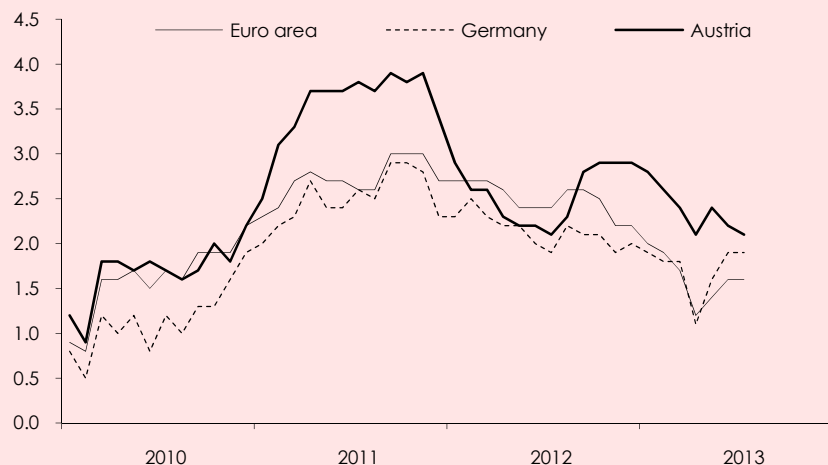
In the first three months of the summer season, the number of guests climbed to a new peak, while the length of stays continued to fall and sales remained below the year-earlier level in real terms.

Inflation slowed further in July

The deceleration in consumer price inflation was due on the one hand to the easing of fuel prices and, on the other hand, to the slowdown in the sharp food price inflation (especially of vegetable prices; July +4.4 percent, June +10.5 percent).

Figure 6: Consumer price developments

Harmonised index of consumer prices, percentage changes from previous year



Q: Eurostat.

Inflation measured by the EU-wide harmonised index of consumer prices also declined in Austria, from 2.2 percent to 2.1 percent in July. Hence the inflation differential vis-à-vis the euro area and Germany fell further. In April and May 2013, HICP inflation in Austria had been around 1 percentage point higher than in Germany and the entire euro area. Since June the differential vis-à-vis the two regions has been decreasing markedly. In July, the rate of inflation was only 0.2 percentage point higher in Austria than in Germany and 0.5 percentage point higher than in the euro area as a whole, respectively.

The inflation differential between Germany and the euro area as a whole is declining again.

Unemployment is rising further in the context of weak economic activity. In August 2013, the number of persons registered as unemployed rose to 263,100, an increase by 30,400 (+13.1 percent) compared with a year before (July 2013 +28,600, +12.6 percent).

At the same time the number of persons in dependent active employment continues to rise slightly (August 2013 +0.7 percent to 3.47 million, +0.1 percent compared with the previous month).

In August 2013, the unemployment rate according to the Austrian method of calculation stood at 6.9 percent (+0.7 percentage point compared with the previous year). Adjusted for seasonal effects, the rate increased to 7.8 percent (+0.1 percentage point compared with the previous month). According to the harmonised method of calculation, the unemployment rate stood at 4.8 percent in July 2013, an increase by 0.1 percentage point from June. Hence Austria continued to have the lowest unemployment rate in the EU, followed by Germany (5.3 percent) and Luxembourg (5.7 percent).

Unemployment rising again