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Persistently Sluggish Activity

There are still no signs of a cyclical recovery in Austria. While surveys for February point to a slight pick-up in business confidence in Germany and Austria, the risks in the international economic and political environment weigh heavily on further developments. Global activity is being held back by the uncertainties surrounding a military conflict with Iraq and, with a view to such an event, the hefty increase in oil prices that have already occurred. In Europe, weak domestic demand, coupled with euro strength, constitutes an additional obstacle to an early upswing. Economic policy keeps refraining from taking substantial counter-action.

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Conditions for an international business cycle upturn have failed to improve over the last months. The biggest risk derives from the looming war in Iraq. This uncertainty is the cause for entrepreneurs holding back with investment. Additionally the rise in oil prices to well above \$ 30 per barrel, as observed in the run-up to the possible military conflict weighs increasingly on economic developments. In Europe, further aggravating factors are first, the rise of the euro above parity to the dollar over the last three months which, though dampening the oil price hike, will burden European exports with a lag of about three quarters. Second, economic policy is hesitant in taking significant counter-cyclical measures. In order to meet the requirements of the Stability and Growth Pact, fiscal policy is following a moderately restrictive course, and for the ECB the goal of price stability seems to leave limited scope for interest rate cuts.

While business sentiment indicators have recently taken a fall in the USA, confidence in the Austrian and German manufacturing sector has improved slightly. In the regular WIFO business survey of February 2003, firms were markedly more upbeat on the current level of orders than in the months before. Also, judgements on business conditions six months ahead have brightened up, although output expectations for the next few months remain stuck at the long-term average. The latest production data, based upon the working-day-adjusted index calculated by Statistics Austria, show for last December a year-on-year increase of a mere 0.8 percent (excluding energy generation).

In Germany, the latest business survey also suggests an improvement in expectations. This goes particularly for judgements on the current situation, while the outlook for the next six months is seen only marginally better than before. To talk about an incipient recovery, seems premature. Apart from the global and European cyclical weakness, Germany will have to consolidate its public finances over the years to come, with dampening effects on internal demand. German GDP in the fourth quarter 2002 remained flat from the previous period.