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Unsolved Problems in European Monetary Union Weighing on Austrian Economy

Business Cycle Report of February 2012

Economic activity lost momentum globally and especially in the euro area over the course of 2011. In the euro area, economic indicators point to persistent stagnation in the first half of 2012. This development is also weighing on the Austrian economy. However, signs are also emerging that it may be stabilising. Nevertheless, the Austrian economy is unlikely to grow in the first quarter. Labour market conditions remain bleak, reflecting the subdued development. Inflation, by contrast, is receding.

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The expansion of the world economy decelerated significantly in the second half of 2011. This slowdown in global economic activity was mainly due to the unfavourable development in the euro area. The uncertainty regarding public finances felt by private households and businesses owing to the ongoing confidence crisis as well as intensified austerity efforts in almost all countries of the euro area are weakening demand. Economic indicators point to stagnation of the euro area economy in the fourth quarter of 2011 and the first quarter of 2012.

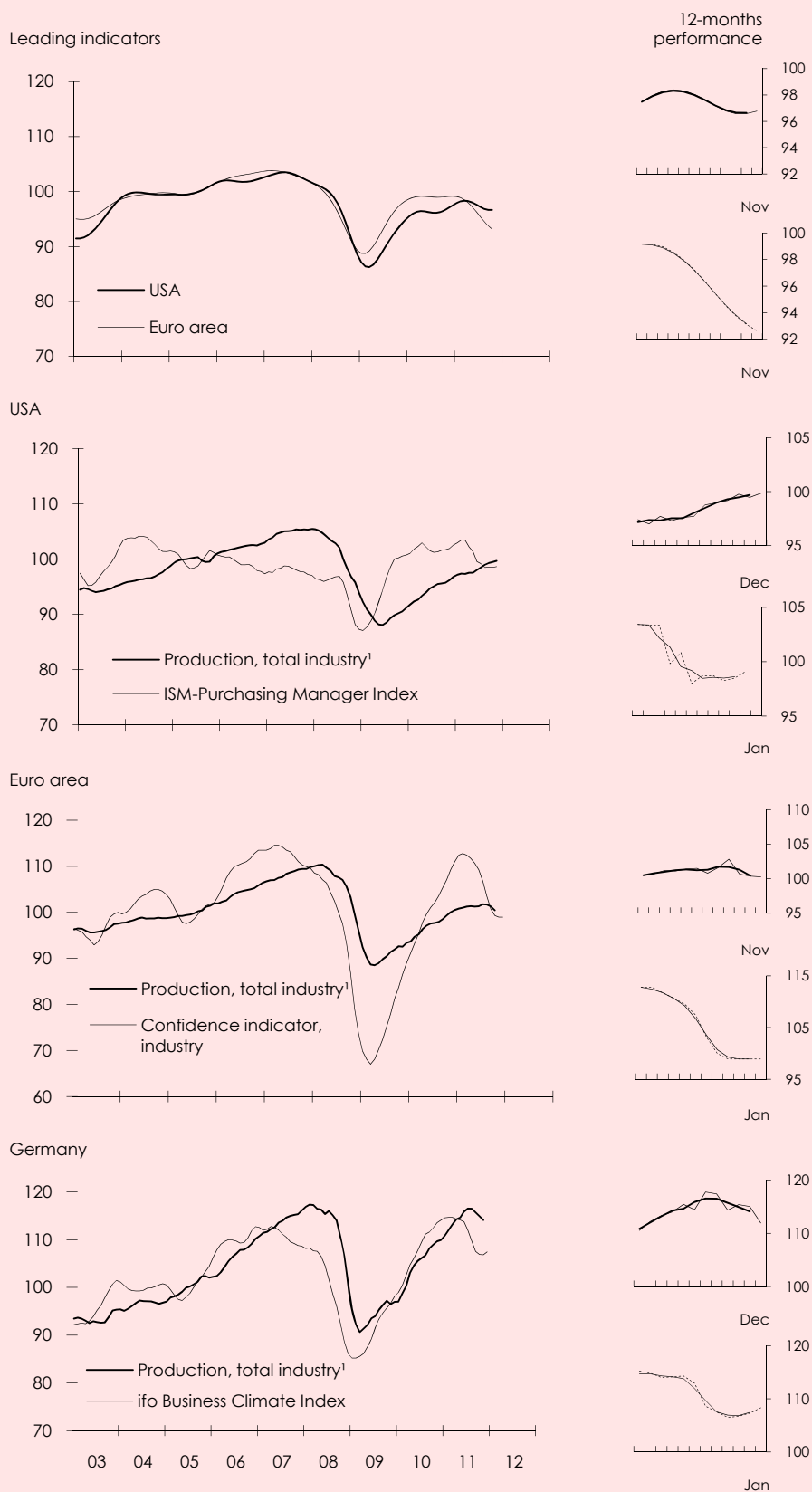
In the USA, by contrast, economic activity gained momentum over the course of 2011; the economy grew vigorously in the fourth quarter. The leading economic indicators give grounds for continued cautious optimism. Labour market conditions are also easing somewhat, reflected in a marked decline in the unemployment rate in January. The upward trend also continues in the Asian emerging market economies and in Japan.

The Austrian economy lost considerable momentum over the course of 2011. Stimulus from abroad declined markedly, owing to the weak development in the euro area. Private consumption and equipment investment, by contrast, remained broadly stable. Economic growth is estimated to have moderated yet again in the fourth quarter of 2011. In WIFO's Business Cycle Survey, the outlook for the future is assessed less favourably than the present situation. This points to continued stagnation in the first half of 2012.

The situation on the Austrian labour market remains bleak. In January, the seasonally adjusted number of persons in dependent active employment hardly rose compared with the previous month. Unemployment remains high; 318,000 persons were registered as unemployed in January. The seasonally adjusted unemployment rate was 6.8 percent in January, according to the Austrian method of calculation, and 4.1 percent in December, according to Eurostat. However, the number of persons enrolled in training programmes also declined. Inflation, by contrast, receded, owing to the decline in commodity and energy prices. In December, annual consumer price inflation as measured by the national CPI was 3.2 percent. Hence the inflation differential vis-à-vis the euro area remains high.

Figure 1: International business climate

Seasonally adjusted, 2005 = 100, 3-month moving average



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

The global economy continues to lose momentum. In November 2011, world trade increased at a month-on-month rate of 1.0 percent in real terms, but the three-month moving average, which is more reliable, given the strong volatility of month-on-month changes, fell by 0.3 percent. Industrial production stagnated in November compared with the previous month, while the three-month moving average declined by 0.1 percent. World trade and industrial production have not been expanding any more since spring 2011.

The stagnation has affected both the industrialised countries and the emerging market economies in recent months. While Asia's emerging market economies are still registering a slight upward momentum, real merchandise imports and industrial production declined sharply in the Latin American countries. Merchandise exports increased in the USA. The euro area registered a marked downward trend, however: in November, the three-month moving average of real merchandise imports fell by 0.9 percent compared with the previous period.

In the USA, the pace of economic activity accelerated over the course of 2011. The economy grew vigorously at +0.7 percent quarter-on-quarter in the fourth quarter of 2011 (third quarter +0.5 percent). The expansion was driven primarily by consumer spending, as well as by the change in inventories. Equipment investment also expanded. The situation in the labour market is beginning to ease somewhat: in January, the seasonally adjusted unemployment rate fell to 8.3 percent, a decline by 0.8 percentage point from August 2011. The number of persons employed increased by 243,000 on a seasonally adjusted month-on-month basis in January.

The leading economic indicators give grounds for continued cautious optimism: the ISM Purchasing Managers' Index rose continuously from November to January. Consumer surveys also reflect more optimistic expectations: the Consumer Sentiment Index rose further in January. The Consumer Confidence Index receded again somewhat in January, albeit after a sharp rise in December. The assessment of industrial new orders, which had improved noticeably in the latter half of 2011, has again deteriorated somewhat lately. The OECD's leading indicator for the USA, by contrast, stabilised towards the end of the year.

A moderation in the pace of economic activity is noticeable also in Asia. China's economy, at +2.0 percent quarter-on-quarter in the fourth quarter of 2011 expanded at a marginally slower pace than in the three preceding months (second and third quarters +2.3 percent). The Purchasing Managers' Index for the Chinese industry, which in November had for the first time since 2009 fallen below the expansion threshold of 50, rose again in December and January, however. Japan's economy, by contrast, should continue to benefit from the reconstruction following the earthquake disaster. Real merchandise imports grew vigorously on average over the months from September to November. Companies' assessments of business conditions improved further, according to the Bank of Japan's Tankan survey.

In the euro area, the crisis of confidence in public finances is weighing on the economy. So far, the EU countries have not been able to present a comprehensive and credible plan for the resolution of the crisis. The yields on Greek, Portuguese and Irish government bonds remain above the level that would render a stabilisation of public debt possible; yields on Italian and Spanish bonds are close to 7 percent. The ongoing uncertainty felt by private households and companies, coupled with an intensification of austerity efforts in most countries of the euro area are weakening demand.

The euro area economy grew by a mere 0.1 percent quarter-on-quarter in the third quarter (second quarter +0.2 percent). Industrial production fell for the third consecutive time in November. GDP estimates for the fourth quarter are not yet available. Evidence from the European Commission's business survey suggests that the pace of economic activity will slow down further. The industrial production index continued its fall in November. There are no signs yet that economic activity may be improving in the first quarter of 2012. Production expectations, industrial confidence as well as consumer confidence did stabilise in January, but the assessment of order

Global economy continues to lose momentum

The crisis of the European Monetary Union is dampening global economic growth. Asia's emerging market economies, the USA and Japan are experiencing continued economic expansion, however.

Weakness in euro area persists

Ongoing uncertainty on account of the crisis of the European Monetary Union and the governments' intensified austerity efforts are dampening growth in the euro area. Activity is expected to stagnate in the first half of 2012.

books deteriorated further. In Germany, economic indicators painted a more favourable picture: the Ifo Business Climate Index and consumer confidence improved appreciably in January. Industrial production, by contrast, is clearly trending downwards in Germany. The economic indicator of the Euroframe Network (Euro Growth Indicator) points to stagnation of the euro area economy in the fourth quarter of 2011 and the first quarter of 2012.

Figure 2: Results from the WIFO Business Cycle Survey

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

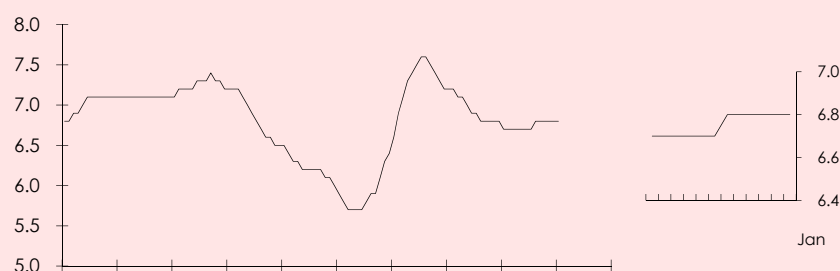


Source: WIFO Business Cycle Survey. Data refer to index points (percentage points) between +100 and -100. Values above 0 imply positive expectations, values below 0 indicate negative expectations.

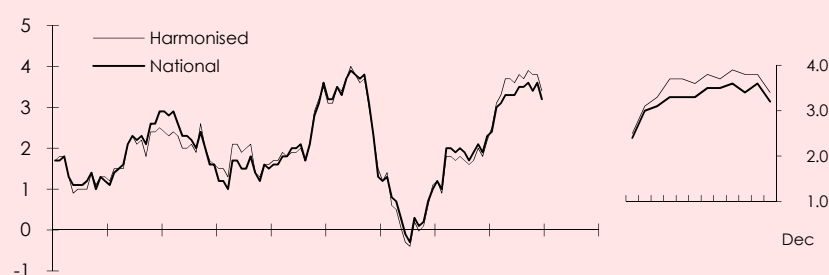
There are considerable tensions in euro area labour markets. The unemployment rate, seasonally adjusted, remained steady at 10.4 percent in December 2011. After rising by 0.4 percentage point since mid-2011, it exceeded its mid-2010 peak at the end of the year. The situation is dramatic in the countries that are severely affected by the crisis: in December, the unemployment rate was 22.9 percent in Spain, 14.5 percent in Ireland, and 13.6 percent in Portugal. It also surpassed the euro area average in the Baltic countries as well as in Bulgaria, Greece, Slovakia and Hungary.

By contrast, inflationary pressures in the euro area remain subdued, largely on account of the persistent decline in energy and commodity prices. At the beginning of February, Brent crude oil prices stood at around \$ 110 per barrel. The HWWI Index of World Market Prices of Commodities excluding energy in US dollar terms was around 13 percent lower than a year before. Annual consumer price inflation slowed to 2.7 percent in December. Core inflation remained stable (HICP excluding energy and unprocessed food +2.0 percent).

Figure 3: Key economic indicators

Persons in active dependent employment¹, (1,000), seasonally adjustedUnemployment rate, traditional Austrian method², seasonally adjusted

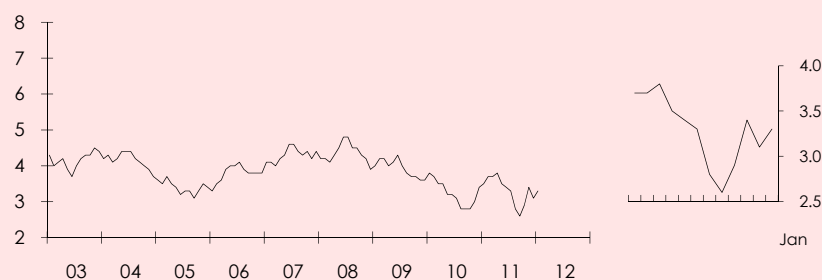
Consumer prices, year-to-year percentage changes



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.

The Austrian economy experienced a marked loss in momentum over the course of 2011. In the third quarter it expanded by 0.3 percent on a seasonally adjusted basis, compared with the previous quarter (first quarter +0.9 percent, second quarter +0.5 percent). The stimulus from abroad declined considerably as a result of the subdued development in the euro area. Private consumption and equipment investment, by contrast, remained broadly stable. Growth is likely to have moderated yet again in the fourth quarter of 2011. Manufacturing production fell persistently in October and November. Firms' assessment of the current situation reached a trough in November, according to the WIFO Business Cycle Survey.

But now there are some tentative signs of a stabilisation. The index for the assessment of the current situation by firms in the manufacturing sector improved again moderately in December and January, and firms gave a more positive appraisal of production developments in the three preceding months; both indicators were roughly in line with their long-term averages. The assessment of both order books and export order books was stable. The percentage of companies reporting a contraction of production was roughly equal to the percentage of companies reporting an expansion. The expectations index also improved in January. Production expectations and business expectations have been rising moderately since October 2011. Nevertheless, pessimistic assessments still outnumber optimistic ones. The business outlook is thus assessed less positively than the present situation. This points to continued stagnation in the first half of 2012.

Construction investment declined again in the third quarter (–0.3 percent, compared with the previous quarter), following a short recovery phase in the first half of 2011. The assessments given in WIFO's Business Cycle Survey of January 2012 are slightly above average, however. Notably order books (seasonally adjusted) show a moderately rising trend. Overall, 75 percent of construction companies assess their order books as being sufficient or more than sufficient. The index of business expectations in the construction sector rose slightly in January.

Tourism sales in the first two months of the 2011–12 winter season exceeded those in the same period a year before by 0.6 percent in nominal terms, according to provisional calculations. This moderate increase was due exclusively to price increases; in real terms, sales contracted by 2.8 percent over the same period. The number of nights spent fell by 0.7 percent in November and December. Real expenditure per night spent – a quality indicator – declined by 3.5 percent. This unfavourable development may be somewhat overdrawn by the fact that the Christmas holidays fell on a weekend. The rate of decline is therefore expected to slow in the course of the winter season.

Overnight stays by foreign travellers declined by 2.0 percent year-on-year in November and December 2011. A favourable trend was recorded in particular with respect to nights spent by guests from Russia (+19.7 percent) and Switzerland (+18.3 percent). High gains were also achieved in the source markets USA (+11.5 percent), France (+11.1 percent) and Belgium (+10.8 percent), while a severe decline was registered in the two markets most important for the Austrian tourism sector, Germany and the Netherlands (–4.1 percent and –22.5 percent, respectively). The number of overnight stays by domestic travellers surpassed the year-earlier level by 2.5 percent.

The situation on the Austrian labour market remains bleak. In January, the seasonally adjusted number of persons in dependent active employment was up by 55,000 from a year before (+1.7 percent), according to an estimate by the Federal Ministry of Labour, Social Affairs and Consumer Protection; in seasonally adjusted month-on-month terms it changed only little, however (+0.1 percent). Unemployment remains high: in January, 318,000 persons were registered as unemployed, an increase by 8,500 from a year before (+2.7 percent, or +0.1 percent in seasonally adjusted month-on-month terms). The number of persons enrolled in training programmes, however, fell by 2,900 compared with a year earlier (–4.2 percent). The number of

Austrian economy is stagnating

The weakening international environment is also weighing on the Austrian economy. Nevertheless, some tentative signs of a stabilisation are emerging. But economic activity in Austria is set to stagnate in the first quarter of 2012. As a result, the situation in the labour market will remain tense. Inflation, by contrast, is receding.

Overnight stays on the decline

Unemployment increases amid rising employment

job vacancies decreased by 14 percent year-on-year. The seasonally adjusted unemployment rate remained unchanged from the previous month and stood at 6.8 percent in January, according to the Austrian method of calculation, and at 4.1 percent in December, according to the definition by Eurostat.

Methodological Notes and Short Glossary

Period comparisons

Time-series comparisons with the previous period, e.g., the previous quarter, are adjusted for seasonal effects. They also include effects that result from a different number of working days in the period (e.g., Easter). In the text, reference is made to "seasonally and working day adjusted changes".

The phrase "changed compared with a year before . . .", on the other hand, describes a change compared with the same period a year before and refers to unadjusted time series.

The analysis of the seasonally and working day adjusted development provides more precise information about the actual course of economic activity and shows turning points sooner. However, the data are subject to additional revisions as seasonal adjustment is based on statistical methods.

Average rates of change

The time given refers to the initial and the final value of the period of computation: hence the average rate 2005-2010 comprises as the first rate of change that from 2005 to 2006, and as the last that from 2009 to 2010.

Real and nominal values

In principle, the values shown must be understood as real values, i.e., adjusted for price effects. Whenever values are shown as nominal values (e.g., foreign trade statistics), this is specifically mentioned.

Production Sector

This term comprises the NACE-2008 sections B, C and D (Mining and Quarrying, Manufacturing, Energy Supply) and is here used in an international comparison.

Inflation, CPI und HICP

The inflation rate measures changes in consumer prices compared with a year before. The Consumer Price Index (CPI) is a measure of national inflation. The Harmonised Index of Consumer Prices (HICP) is the basis for comparable measurement of inflation in the EU and for the evaluation of price stability in the euro area (see <http://www.statistik.at/>).

Core inflation as a monetary policy indicator is not clearly defined. WIFO follows the common practice of using the inflation rate excluding the product categories unprocessed food and energy for core inflation. Thus just under 87 percent of the goods and services contained in the consumer price index (CPI 2010) are included in the calculation of core inflation.

WIFO Business Cycle Survey and WIFO Investment Survey

The WIFO Business Cycle Survey is a monthly survey in which around 1,100 Austrian firms are asked to assess their current and future economic situation. The WIFO Investment Survey is conducted twice a year, asking companies about their investment activity (<http://www.konjunkturtest.at/>). The indicators are balances between the positive and negative responses expressed as a percentage of the total number of firms sampled.

Unemployment rate

Austrian national definition: The number of persons registered as job seekers with the Public Employment Service expressed as a percentage of the dependent labour force. Labour force is the sum of the unemployed and the persons in dependent employment (measured in standard employment relationships). Database: registrations with the Public Employment Service (AMS) and Association of Austrian social insurance agencies.

Definition according to ILO and EUROSTAT: Any person who is not gainfully employed and is actively seeking work is considered unemployed. Gainfully employed persons comprise all persons who during the reference week worked for at least one hour in a self-employed capacity or in paid employment. Persons receiving child-care benefit and apprentices are classified as gainfully employed, whereas persons in military service or persons carrying out alternative service are not. The unemployment rate is the number of unemployed persons expressed as a percentage of the total labour force (unemployed persons plus gainfully employed persons). Database: data from household surveys ("Mikrozensus").

Terms used in connection with the national definition of the unemployment rate

Persons in training: Persons who at a set date are enrolled in AMS (Public Employment Service) training programmes. When calculating the unemployment rate, their number is not taken into account either in the denominator or in the numerator.

Persons in dependent active employment: "Persons in dependent employment" include persons receiving child-care benefit, as well as persons in military service or persons carrying out alternative service with a valid employment contract. By deducting their number one arrives at the number of "persons in dependent active employment".

In December, annual consumer price inflation as measured by the national CPI was 3.2 percent. The strongest price increases were registered in the education, transport, alcoholic beverages and tobacco, food and non-alcoholic beverages as well as in the housing, water and energy categories. Inflation has thus again receded somewhat recently.

The harmonised inflation rate (HICP) stood at 3.4 percent in December, exceeding the euro area average by 0.7 percentage point. Core inflation (HICP excluding energy and unprocessed food) was 2.8 percent (euro area 2.0 percent). The biggest contributors to the inflation differential were higher-than-average price increases in the categories of recreation and culture as well as restaurants and hotels. By contrast, price increases in the housing, water and energy categories were markedly lower than on euro area average.

Inflation is receding