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# Economic Recovery Strengthening

## Business Cycle Report of November 2013

**In Austria, prospects for a pick-up in economic activity are firming. WIFO's latest Business Cycle Survey as well as the most recent expansion of production point to a gradual recovery of industrial activity. WIFO's Leading Indicator also improved for the third time. Leading indicators for the euro area and the EU as a whole also signal a continuation of the upward trend.**

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: 7 November 2013. • E-mail address: [Sandra.Bilek-Steindl@wifo.ac.at](mailto:Sandra.Bilek-Steindl@wifo.ac.at)

World trade is expanding at a steady pace; advanced economies (notably the USA and Japan) have recently made a larger contribution to growth than emerging market economies. While in the USA consumer confidence weakened in the aftermath of the partial spending freeze in October, industrial activity remained stable. Japan's economy has recently strengthened again due to increased domestic and export demand. In China, growth did accelerate again moderately in the third quarter, but there are signs of a reorientation of the economy with flattened growth rates.

In the EU as a whole and in the euro area, the positive trend observed in recent months persists: following an expansion of industrial production in August, leading indicators released by the European Commission signal a slow recovery. In September the unemployment rate remained steady compared with the previous month, but was very high at 12.2 percent (euro area) and 11.0 percent (EU), respectively.

The positive economic momentum continued also in Germany. The industrial sector registered a considerable increase in sales in August, owing to the pick-up in domestic as well as foreign demand. Exports and retail trade also gained traction.

Following stagnation, prospects for an improvement in economic conditions have firmed also in Austria in recent months. Both WIFO's Business Cycle Survey and WIFO's Leading Indicator signal a slow upward trend.

CPI inflation has been falling continuously since the beginning of 2013, and in September stood at 1.7 percent. Notably fuel prices were considerably lower than in September 2012. The favourable economic prospects also brighten domestic consumer confidence. Following the decline observed since the beginning of the year, real retail sales are likely to have picked up in the third quarter compared with a year before. Activity in the tourism industry has been tepid recently, with sales dampened by guests' low willingness to spend.

The number of persons registered as unemployed rose by 12.2 percent year-on-year in October, with construction and the health and social care sector registering the strongest increases. In seasonally adjusted month-on-month terms, unemployment rose by 0.5 percent, while employment increased marginally by 0.1 percent.

World trade expanded at a rate of 0.3 percent on average from June to August compared with the previous period. While both imports and exports of Asian emerging markets declined further compared with the previous quarter, those of advanced economies – notably the USA and Japan – accelerated.

In China, signs are emerging of a re-orientation of the economy with stronger focus on private consumption, which has been accompanied by flattening GDP growth already for a second consecutive year. While growth has again accelerated somewhat recently (second quarter +1.9 percent, third quarter +2.2 percent, quarter-on-quarter), the cumulative annual rate, at +7.7 percent, is well below the average of the past five years. The cumulative expansion of industrial production from January to September 2013 also remained below that seen in previous years. Leading indicators suggest that activity will stay lively or will even accelerate in the fourth quarter. The HSBC Manufacturing Purchasing Managers' Index climbed to a seven-month high of 50.9 in October, and that of the National Bureau of Statistics China also rose.

In Japan, the recovery continues, with GDP growing at a quarter-on-quarter rate of 0.9 percent in the second quarter. Leading indicators point to a positive development also in the fourth quarter. The latest Tankan business survey paints an optimistic picture of business sentiment. The economic recovery has supported consumption. However, the acceleration in consumer spending in September may in part have been due to consumers bringing forward some purchases in anticipation of the VAT increase planned for April 2014. The growth in consumption, along with the continuing distinctly expansionary economic policy and higher import prices due to the weakness of the yen has supported a moderate pick-up in consumer prices. The significant depreciation has strengthened exports; but with the cost of imports rising amid persistently high energy demand nominal imports have also increased.

Commodity markets currently lack momentum. The HWWI Index of World Market Prices of Commodities, which comprises food, beverages and tobacco as well as energy and industrial raw materials, stagnated in October in dollar terms (+0.3 percent compared with a year before). Declines in food, beverages and tobacco as well as industrial raw material prices found a counterpart in moderate price increases for agricultural raw materials and energy. Brent crude oil prices averaged \$ 109 per barrel in October, a decline of around 2 percent from a year before.

In the USA, economic activity remains stable. Uncertainty had been caused by the budget quarrel. During a partial spending freeze public funding was limited exclusively to expenses the government is legally obliged to pay. Other expenditure such as the payment of salaries was frozen, and federal agencies were shut down for a short period of time. A temporary solution until January 2014 put a halt to this spending freeze in mid-October. The effects on the economy have likely not been very strong. However, consumer confidence deteriorated considerably in October, according to the Conference Board as well as Reuters and the University of Michigan. Private household wealth benefits from the recovery of the real estate market. The S&P/Case-Shiller Index has been rising already since February 2012 (month-on-month). Private consumption may nevertheless have slowed down in the third quarter of 2013, retail sales declined somewhat in September compared with the previous month.

Industrial activity remains strong. Capacity utilisation rose in both August and September, compared with the respective previous month. At 78.3 percent at its most recent reading, it was still somewhat below its long-run average (1972-2012: 80.2 percent), but 1.1 percentage points above its level in September 2012. The renewed rise of the Purchasing Managers' Index (PMI) in October to its highest level in more than two years (56.4 percent) points to continuing expansion.

The positive trend seen in recent months in the EU as a whole and in the euro area persists. Industrial production increased, month-on-month, in August (euro area +1.0 percent, EU as a whole +0.5 percent), but still remained below its year-earlier level.

## World trade robust, commodity markets lack momentum

*World trade continues to expand modestly. Growth has been driven more strongly by advanced economies.*

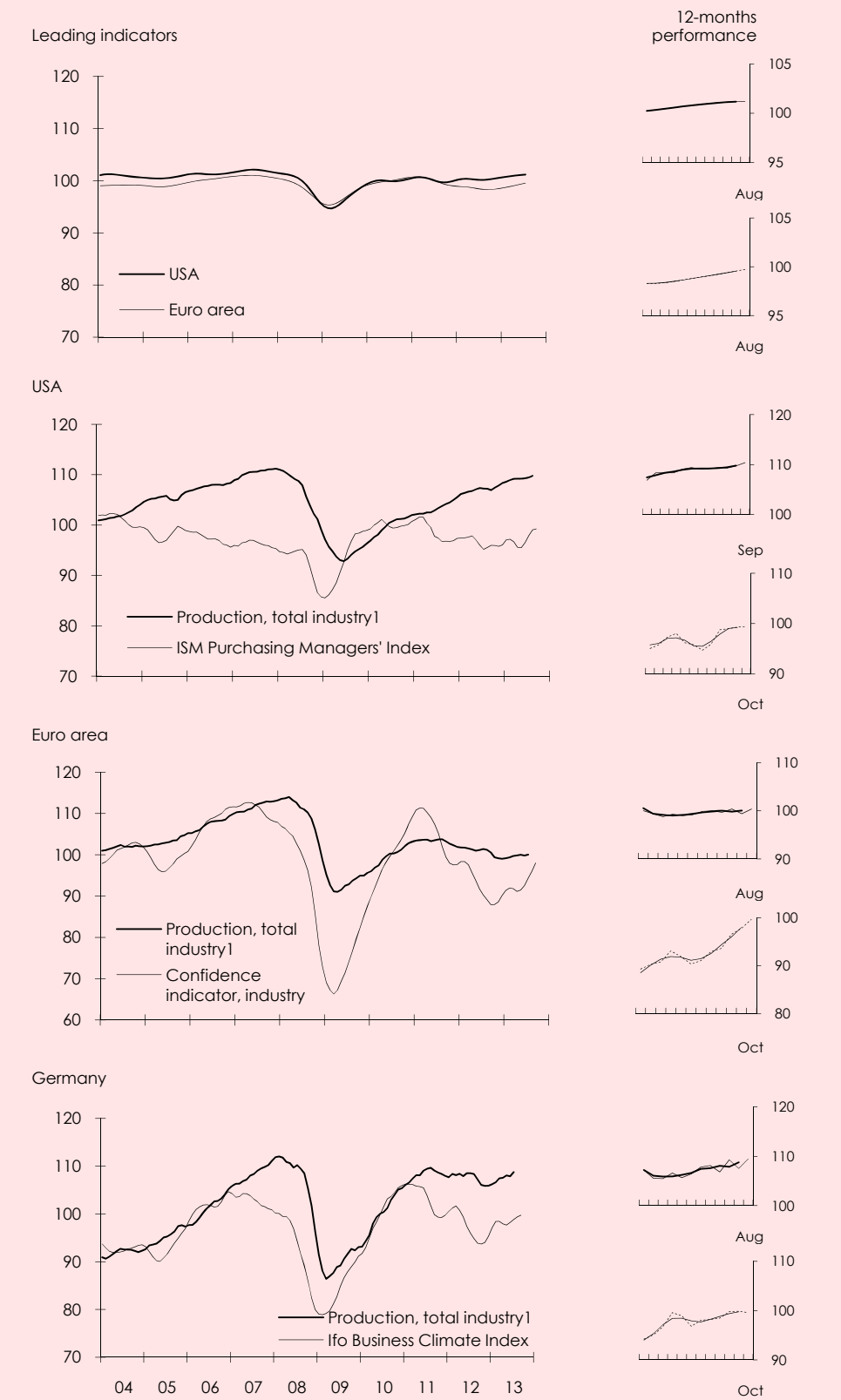
## US economy remains stable

*In the USA, the budget quarrel and the subsequent partial spending freeze impacted consumer confidence. However, the problems surrounding the federal budget are assumed to barely dampen economic activity.*

## Economic recovery in the EU

Figure 1: 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.

Following an expansion of industrial production in August, leading indicators suggest that the economic recovery will proceed.

Leading indicators suggest a continuation of the positive momentum in the fourth quarter. In October, the European Commission's Economic Sentiment Indicator improved further in both the euro area and the EU as a whole. Notably the survey re-

sults for industry were clearly better than previously, with both production expectations and the assessment of order book levels improving. The overall indicator shows an upward trend for three out of the five large euro area economies (Netherlands, France and Germany), while it fell in Spain and Italy. The Purchasing Managers' Index for the euro area moved up further in September. Notwithstanding this positive trend, neither the euro area nor the EU as a whole is expected to see GDP increase before 2014.

The labour market is also showing tentative signs of stabilisation. In September, the seasonally adjusted unemployment rate no longer increased in the euro area compared with the previous month, but remained steady (12.2 percent). Having risen continuously over the preceding 12 months, it nevertheless remained clearly above its level of September 2012 (11.6 percent). Meanwhile, in the EU as a whole the rate has been steady at 11.0 percent since January 2013 (September 2012: 10.6 percent). Among EU countries, the lowest rates were recorded in Austria (4.9 percent) and Germany (5.2 percent), and the highest in Greece (27.6 percent in July 2013) and Spain (26.6 percent). The high level of youth unemployment remains of particular concern: in September 2013 it averaged 23.5 percent in the EU and 24.1 percent in the euro area.

Euro area inflation stood at 1.1 percent in September. Eurostat's flash estimate for October assumes a further fall to 0.7 percent. Notwithstanding a short-term increase in the summer, the inflation rate has thus been falling for a year, reaching its lowest level since November 2009. In September 2012, inflation had still come in at 2.6 percent. This decline is largely attributable to the drop in fuel prices, but the rate is also lower when energy prices are excluded. In September, prices declined for instance in the telecommunications sector. The sub-components having the largest upward impacts on headline inflation were tobacco and electricity. Price developments were highly heterogeneous across EU countries: while prices did not rise in Greece (-1.0 percent) and Ireland (0 percent), inflation climbed to 2.7 percent in the UK, 2.4 percent in the Netherlands, and 1.8 percent in Finland.

Following very strong growth – overdrawn by special effects – in the second quarter (+0.7 compared with the previous quarter), economic activity in Germany remained strong also in the third quarter. The Ifo Business Climate Index did slightly deteriorate in October following its rise in previous months, but the decline was smaller than the increase seen in the months before and should therefore not be overrated. Businesses continue to be very optimistic in their export expectations on the back of the gradual recovery experienced in the euro area.

With both domestic and foreign demand picking up, sales in industry increased considerably already in August (+2.4 percent, month-on-month), especially those to foreign customers. In parallel with this increase, exports rose by 1 percent in August compared with July, but still remained below their year-earlier level. Notably exports to non-EU countries were considerably lower than in 2012.

Retailers also saw business thrive in August, with sales exceeding the level of July 2013. In September they were again slightly lower than in the previous month, however.

The Austrian economy stagnated in the first half of 2013; especially equipment investment has been declining on a quarter-on-quarter basis since the second quarter of 2012. Prospects for somewhat more favourable economic conditions have been firming recently: as in the two previous months, WIFO's Leading Indicator improved in October. The number of job vacancies, production expectations in the Austrian industry as well as the Ifo Business Climate Index for Germany did fall slightly in October, but all the other sub-components continued the positive development seen in recent months. The results of the WIFO Business Cycle Survey of October 2013 also show a more positive assessment of the situation by companies, with the improvement extending to all sectors (goods manufacture, construction, services). The ma-

### **Euro area inflation falling markedly**

*According to Eurostat's flash estimate, inflation in the euro area fell to 0.7 percent in October, the lowest reading since November 2009.*

### **German economy remains lively**

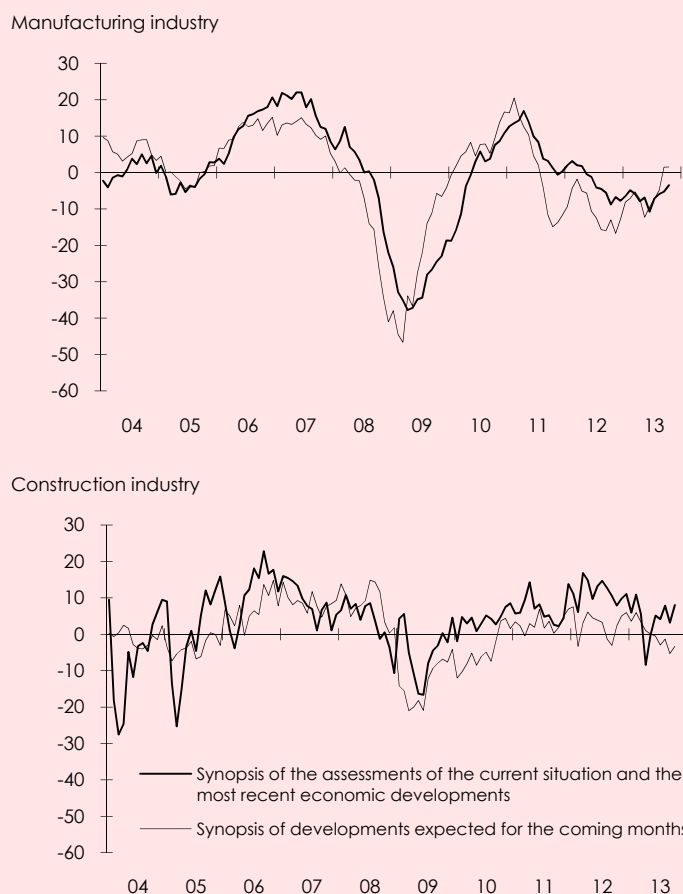
*Economic activity remains strong also in Germany, although its pace has slowed somewhat compared with the second quarter.*

### **Austria: positive expectations are firming**

majority of companies are optimistic and expect the economy to improve in the coming months. However, the results of the business cycle survey to not yet indicate a clear trend reversal, companies do not rule out setbacks in the coming months. Likewise, the results of surveys on capacity utilisation suggest only a tentative recovery of industrial activity. Since April 2013, capacity utilisation in the manufacturing sector has been just over 80 percent, the lowest level seen in three years.

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.

Meanwhile, production developments have been more favourable recently. The seasonally adjusted industrial production index rose modestly in both July and August. At the same time goods exports rebounded. In July, they exceeded the year-earlier level by 3.5 percent, while imports rose by 2.3 percent, according to the foreign trade statistics. Cumulative exports for the period from January to July increased by 1.6 percent, year-on-year, while imports declined by 2.3 percent.

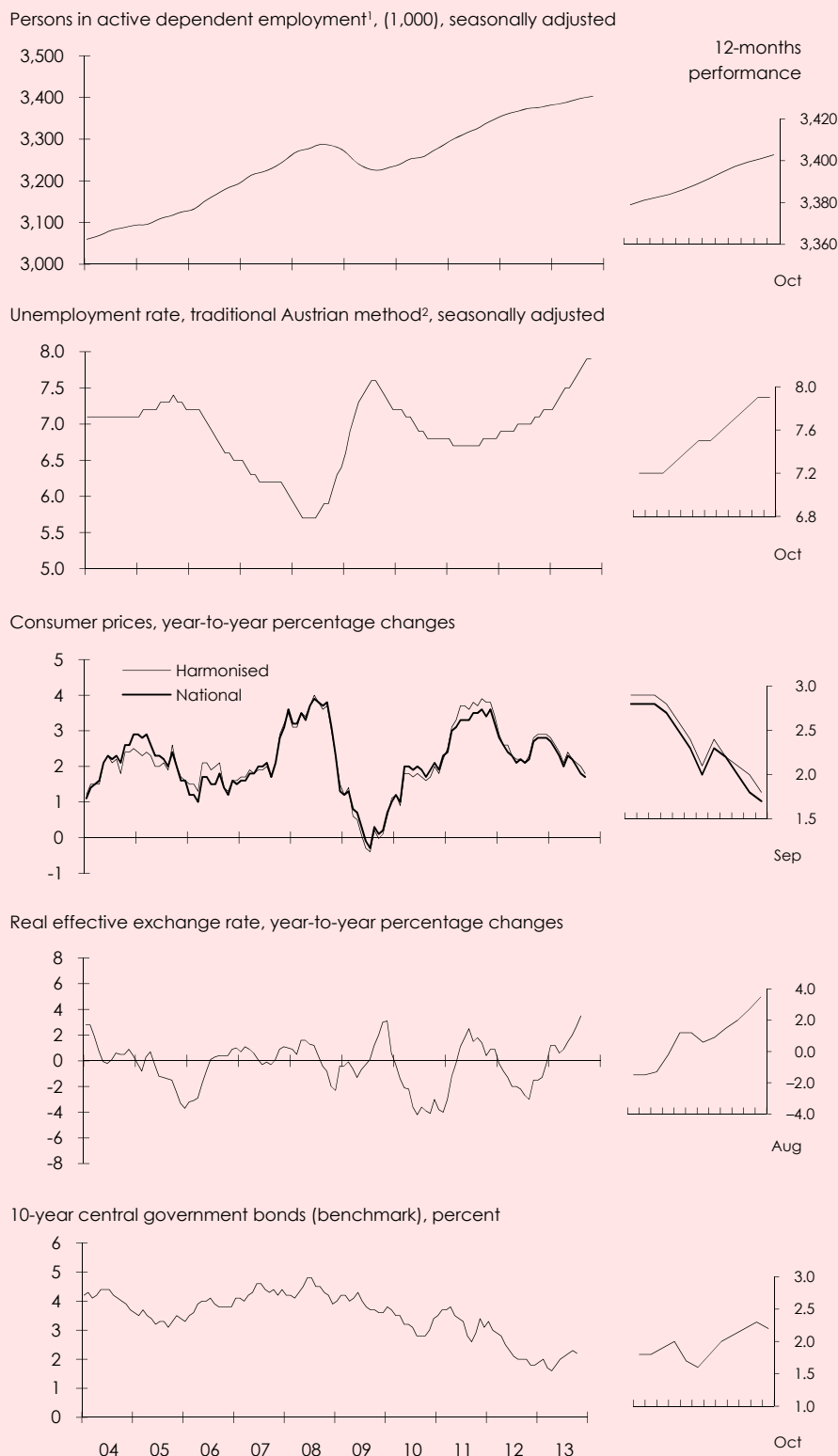
The inflation rate stood at 1.7 percent in September (after 1.8 percent in August). Inflationary pressures have been easing continuously for a year. Especially fuel prices were considerably lower in September 2013 than a year before (-6.1 percent), when the rate of inflation had still been 2.7 percent. However, the increase in the Harmonised Index of Consumer Prices (HICP), at 1.8 percent once again exceeded the euro area average (1.1 percent). Overall, the upward drift in prices in September was again largely driven by price increases in the housing, water and energy as well as food categories. Maintenance costs of rented apartments rose by 3.9 percent, those of owner-occupied apartments by 3.4 percent.

Leading indicators and the increase in the production index signal a slow recovery of industrial activity in Austria.

**Inflation falling further,  
consumer sentiment  
brightening**

Figure 3: Key economic indicators

The more optimistic assessment of the economic situation boosts consumer confidence.



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

With the easing of inflation, consumer confidence is slowly brightening in Austria. The European Commission's Consumer Confidence Indicator has been improving in Austria since mid-2013. In the October survey, pessimistic appraisals still predominated, but the balance was higher than on average over the last five years. The renewed

increase in the consumer confidence indicator is attributable to a more positive assessment of the general economic situation over the next 12 months as well as to an improved assessment of the future labour market situation. However, consumers' willingness to purchase consumer durables (for instance new passenger cars) remains highly tepid, according to available data. In the first three quarters of 2013 the total number of new passenger car registrations fell by 7 percent compared with the same period a year before, with new registrations for private individuals even experiencing a double-digit drop (cumulative decline from January through September –13.1 percent).

Real retail sales are assumed to have picked up again in the third quarter compared with the downward trend observed in the first and second quarters. Food retailers posted very high gains in the third quarter. Sales of non-food items were still partly subdued in July and August, according to available data. In general, the sentiment among retailers has gradually improved in recent months, though. In the WIFO Business Cycle Survey of October 2013 companies gave a much more optimistic assessment of both the current business situation and the business outlook than on average over the last 12 months.

Preliminary calculations on tourism sales growth from May to September 2013 showed a nominal increase of 1.3 percent compared with the same period a year before. In price adjusted terms, by contrast, revenue fell by 0.7 percent. The tepid sales growth reflects the fact that guests are becoming increasingly savings-minded; this is apparent especially in the decline in real expenditure per night spent (–1.7 percent) or in the vigorous growth of nights spent in commercial holiday apartments, private holiday homes and apartments.

The number of nights spent in the first five months of the 2013 summer season rose by 1.0 percent on aggregate compared with the same period a year before. While international demand posted above-average growth (+1.5 percent), demand from resident guests remained flat.

Developments of demand for a holiday in Austria from May to September 2013 were mixed across the major international source markets: there was a strong increase in the number of nights spent by guests from Russia (+9.5 percent), the UK (+9.4 percent), Poland (+7.3 percent), the USA (+6.5 percent) and Hungary (+5.1 percent). Demand from Belgian and German guests increased at a lower than average rate (+1.1 percent and +1.0 percent, respectively). A small to moderate decline was registered in all the other important source markets (Romania –0.7 percent, Switzerland –0.9 percent, France –1.5 percent, Netherlands –1.8 percent, Denmark –2.4 percent, Italy –2.5 percent).

The labour market situation remains tense, with the number of unemployed persons increasing further in October, despite employment growth. The number of persons in dependent active employment rose by 0.8 percent compared with a year before. Compared with the previous month, employment rose modestly in seasonally adjusted terms (+0.1 percent). The number of job vacancies registered with the Public Employment Service declined further (–2,958). At the same time the number of persons unemployed kept rising: in October, 280,336 persons were registered as unemployed, an increase of 30,424 compared with October of last year. The number of persons enrolled in vocational training programmes also continues to rise. Overall, 38,251 more people were without a job in October than a year earlier. Unemployment is rising substantially especially in the construction and the health and social care sectors.

According to the Austrian method of calculation, the unemployment rate stood at 7.4 percent in October, an increase of 0.7 percentage point compared with the rate recorded a year before.

### Subdued activity in tourism

*The decline in guests' willingness to spend dampens sales growth in the tourism industry.*

### Number of unemployed rising amid continued employment growth