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Export Industry Growing Vigorously, Energy Price Increases Weighing on Economic Activity

Business Cycle Report of March 2011

The upturn in the export and manufacturing sectors is driving the economic recovery in Austria. In the fourth quarter of 2010, real GDP expanded by 0.8 percent compared with the previous quarter and by 2.7 percent compared with a year before. Investment activity is beginning to pick up, however, not in the construction sector. Private consumption is growing steadily, albeit modestly. Supported by lively industrial activity, unemployment continues to decline slowly. Consumer price inflation is accelerating, reflecting soaring energy prices; this is the reason for a marked contraction in real wages per capita.

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The recovery of Austria's export industry from the recession continues to make headway. In December 2010, the seasonally adjusted manufacturing production index was 12 percent above the trough reached in May 2009; thus almost four fifths of the production decline registered since autumn 2008 have been made good. The upward trend is set to continue, according to the results of the WIFO business cycle survey of February: companies' production expectations are at a high level, having improved yet again at the beginning of the year, to a balance of +21 percentage points; incoming orders and the assessment of the business situation in six months reflect the positive sentiment.

The brisk upswing observed in Asian and Latin American emerging economies is the engine powering buoyant industrial activity. Their imports are driving world trade; in the fourth quarter of 2010, seasonally adjusted world trade volumes rose by 2.6 percent quarter-on-quarter, and by 11.3 percent year-on-year, in real terms. Austria's export industry benefits from the global expansion mainly through supplier relations with the world-market oriented German economy. German GDP is expanding vigorously, pulling along the economies of a number of industry-oriented EU countries. EU countries with persistent structural problems and a predominantly restrictive budget policy, by contrast, remain in recession. On euro-area average, the recovery is progressing only tepidly.

In the fourth quarter of 2010, Austrian merchandise exports expanded by 1.0 percent from the previous quarter, exceeding the trough in the second quarter of 2009 by 23 percent in seasonally adjusted terms. Equipment investment is beginning to pick up, reflecting rising exports and growing capacity utilisation in manufacturing. Construction investment, by contrast, continues to contract, also because the Länder are trimming spending on housing projects.

Private consumption in Austria grew slightly also during the recession and was thus an important stabilising factor for the economy. Now it continues to grow moderately; in the fourth quarter it rose by 0.2 percent compared with the previous quarter, and by 0.7 percent compared with a year before. This was largely due to the increase in employment: according to provisional estimates, 3.2 million people were in dependent active employment in February 2011, an increase by around 64,000 from a year before. A decisive factor here – apart from the steadily rising number of job

offers in the services sectors – was the recovery of employment in industry. The number of unemployed persons continued to fall markedly at the beginning of the year. In February, 292,000 people were registered as unemployed, a decline by 21,000 from a year before. In seasonally adjusted terms, the number of unemployed persons stood at 241,000, 31,000 below the peak in August 2009. Thus only less than half of the increase in unemployment triggered by the recession has been offset so far.

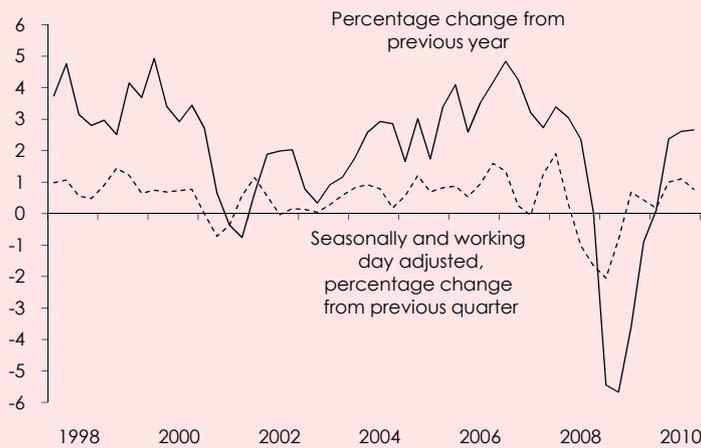
Table 1: Quarterly national accounts

			2009		2010			
			Third quarter	Fourth quarter	First quarter	Second quarter	Third quarter	Fourth quarter
			Percentage changes from previous quarter					
<i>Adjusted for seasonal and working day effects, volume</i>								
Final consumption expenditure			+ 0.5	- 0.1	+ 0.0	+ 0.3	+ 0.2	+ 0.2
Households ¹			+ 0.3	+ 0.2	+ 0.2	+ 0.2	+ 0.2	+ 0.2
General government			+ 1.3	- 0.3	- 3.2	+ 0.3	+ 0.1	+ 0.3
Cross capital formation			- 0.7	+ 0.1	+ 0.3	+ 2.5	+ 3.0	+ 2.8
Gross fixed capital formation			- 0.2	- 0.8	- 1.1	+ 0.3	+ 1.2	+ 1.1
Machinery and equipment			- 1.6	- 1.0	- 0.1	+ 1.1	+ 1.6	+ 1.2
Construction			- 0.6	- 0.6	- 0.9	- 0.9	- 0.8	- 0.7
Exports, goods and services			+ 1.7	+ 2.7	+ 3.2	+ 4.2	+ 3.2	+ 1.2
Goods			+ 3.5	+ 2.5	+ 3.1	+ 6.6	+ 4.7	+ 1.0
Services			- 0.7	+ 1.1	+ 2.8	+ 2.3	+ 1.8	+ 1.4
Imports, goods and services			+ 0.8	+ 1.1	+ 2.4	+ 3.7	+ 2.7	+ 0.8
Goods			+ 2.2	+ 1.6	+ 1.6	+ 4.2	+ 3.6	+ 0.6
Services			- 1.8	- 0.2	+ 0.9	+ 2.3	+ 1.4	+ 0.4
Gross domestic product			+ 0.7	+ 0.4	+ 0.2	+ 1.0	+ 1.1	+ 0.8
Manufacturing			+ 2.2	+ 0.7	+ 0.8	+ 3.9	+ 3.5	+ 1.5
	2009	2010	2009		2010			
			Third quarter	Fourth quarter	First quarter	Second quarter	Third quarter	Fourth quarter
			Percentage changes from previous year					
<i>Volume, chained prices</i>								
Final consumption expenditure	+ 1.1	+ 0.1	+ 2.3	+ 0.3	+ 1.8	- 1.2	- 0.0	- 0.2
Households ¹	+ 1.3	+ 1.0	+ 2.7	+ 0.5	+ 3.2	- 1.1	+ 1.1	+ 0.7
General government	+ 0.4	- 2.4	+ 1.2	- 0.1	- 2.0	- 1.7	- 3.3	- 2.6
Cross capital formation	- 12.7	+ 3.8	- 11.8	- 8.5	- 7.8	+ 6.1	+ 4.5	+ 9.6
Gross fixed capital formation	- 8.8	- 1.3	- 6.6	- 5.6	- 5.8	- 1.2	- 0.7	+ 1.5
Machinery and equipment	- 14.5	+ 1.8	- 13.1	- 12.0	- 6.1	+ 1.1	+ 3.5	+ 8.6
Construction	- 6.0	- 3.4	- 3.6	- 1.6	- 5.5	- 2.5	- 3.4	- 3.0
Exports, goods and services	- 16.1	+ 10.8	- 15.6	- 7.5	+ 4.3	+ 13.6	+ 14.2	+ 11.5
Goods	- 18.6	+ 12.6	- 17.5	- 7.6	+ 5.0	+ 16.1	+ 16.5	+ 12.7
Services	- 9.5	+ 6.8	- 10.6	- 7.6	+ 2.6	+ 7.3	+ 8.8	+ 9.0
Imports, goods and services	- 14.4	+ 9.2	- 12.5	- 9.6	+ 3.2	+ 10.7	+ 12.6	+ 10.3
Goods	- 15.3	+ 10.5	- 13.2	- 9.0	+ 4.5	+ 12.6	+ 14.0	+ 10.8
Services	- 10.7	+ 4.6	- 10.0	- 11.6	- 1.5	+ 3.6	+ 7.3	+ 8.5
Gross domestic product	- 3.9	+ 2.0	- 3.6	- 0.9	+ 0.1	+ 2.4	+ 2.6	+ 2.7
Manufacturing	- 14.3	+ 6.7	- 14.1	- 6.8	- 0.1	+ 9.3	+ 8.2	+ 8.9
Gross domestic product, value	- 3.1	+ 3.5	- 2.9	+ 0.0	+ 1.4	+ 3.7	+ 4.4	+ 4.5

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

The weak recovery in the euro area and the unstable financial system have so far been regarded as the highest risks facing the economy. On top of that, commodity prices are now soaring. At the beginning of March, the price of Brent crude exceeded \$ 110 per barrel, compared with still just under \$ 80 a year earlier. World market prices of agricultural and metal raw materials have also increased strongly. This has already fed through into consumer prices: in January, inflation in Austria reached 2.4 percent. More than one third of this price rise was a result of the increase of mineral oil product prices (fuels and heating oil). In February, wholesale prices were 12.7 percent above their year-earlier level. Hence the increase in consumer prices already exceeded the increase in negotiated wages by $\frac{3}{4}$ percentage point.

Figure 1: Growth of real GDP



Source: WIFO.

World trade rebounded vigorously at the end of 2010, following stagnation from May to September 2010. In the fourth quarter, the seasonally adjusted world trade volume exceeded its year-earlier level by 2.6 percent in real terms (third quarter +0.7 percent), according to CPB. Imports of the industrialised countries did continue to rise only modestly, but the emerging economies increased theirs markedly. The underlying momentum of economic activity remains buoyant particularly in Asia. In the fourth quarter of 2010, China's real GDP rose by almost over 10 percent compared with a year before; investments and consumer demand continue to expand strongly. Signs of overheating in real estate and stock markets are abating somewhat; by contrast, inflation at the consumer level is accelerating; China's monetary policy response is to gradually increase interest and minimum reserve rates.

The upward drift in prices stems mainly from the sharp increases in commodity prices. The world market price of crude oil has been rising for several months now, most recently at an accelerated pace owing to the unrest in the Arab region. At the beginning of March, Brent crude topped \$ 110 per barrel. Food prices, especially those for cereals, have increased even more strongly recently. Here the ongoing vigorous growth in global demand, coupled with the consequences of several crop failures, comes to bear. The prices of metal raw materials are also rising appreciably. These inflationary trends are likely to be intensified by speculative financial investments.

The US economy continues to expand at a moderate pace: in the fourth quarter, real GDP grew by 0.7 percent quarter-on-quarter and by 2.7 percent year-on-year. Industrial production is expanding steadily, benefiting from exports as well as private household demand for durable consumer goods. The real estate sector remains the main weak point of the economy. It is true that house prices, after declining for three years, are not falling further, but a recovery is not in sight. This weighs not only on the construction industry, but also on mortgage banks and hence on the entire financial system.

The situation in the labour market is slowly improving: employment has grown slightly, and first-time claims for unemployment benefits have dropped noticeably of late. In February, the seasonally adjusted unemployment rate was 8.9 percent of the labour force, more than 1 percentage point lower than the peak in October 2009, however, more than 4 percentage points higher than before the recession. The decline in unemployment supports household consumption, which in the fourth quarter rose by 2.6 percent in real terms compared with the same period a year before. Another contributing factor was a slight drop in the saving ratio to 5.4 percent of disposable incomes.

Demand from Asian emerging economies driving global trade

Demand continues to expand at a brisk pace in the emerging economies, particularly in Asia. This is the engine powering world trade. Consumer price inflation is picking up, however, fuelled by higher commodity prices.

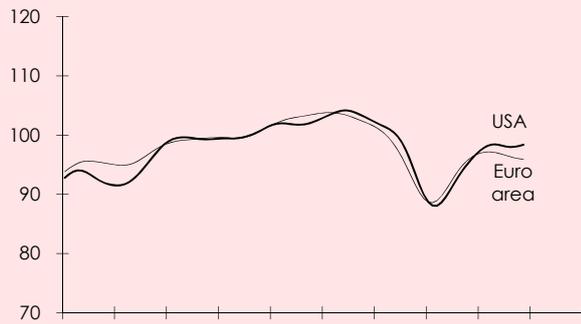
US GDP expanding further

In the USA, the economic recovery is continuing, supported by exports and consumer demand. Labour market conditions are improving at a faster pace than in the EU, yet the unemployment rate is clearly higher than prior to the recession.

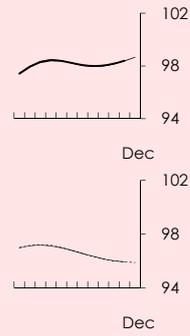
Figure 2: International business climate

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

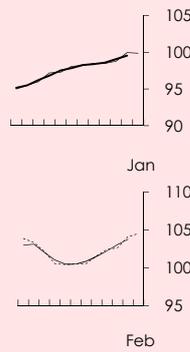
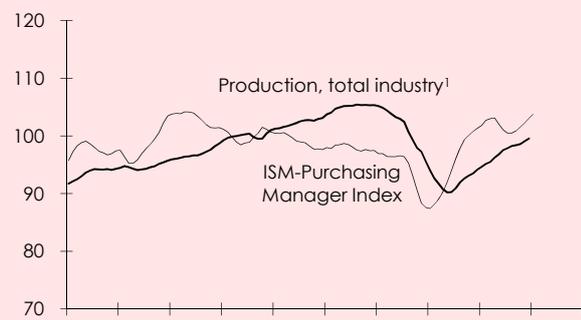
Leading indicators



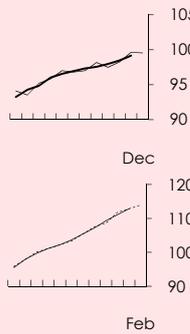
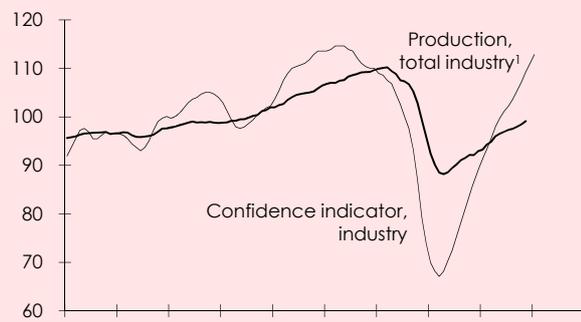
12-months performance



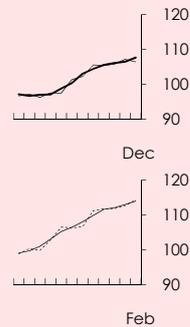
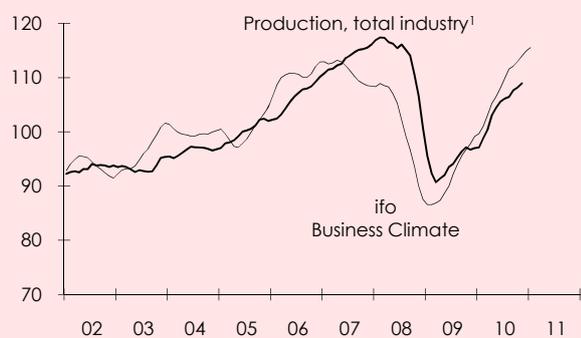
USA



Euro area



Germany



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

In the EU, the economic recovery flattened considerably. In the fourth quarter, real GDP rose by a mere 0.2 percent compared with the previous quarter and by 2.1 percent compared with a year before. Economic developments were highly uneven across countries:

- Industry-oriented economies, which include Germany, Austria, the Benelux and the Scandinavian countries as well as the Czech Republic and Slovakia, expanded noticeably. They have a highly competitive industry and benefit from growing imports of Asian and Latin American emerging economies. The upturn in industrial activity persisted around the turn of the year, and is expected to continue further, according to economic surveys conducted by the European Commission. The German export industry, benefiting from its orientation toward capital goods and motor vehicles, has proved particularly strong. German real GDP rose by 4 percent year-on-year in the fourth quarter of 2010, and by 3.6 percent on average for the year 2010 as a whole. Favourable labour market conditions are increasingly supporting consumer demand, traditionally a weak point of the German economy.
- By contrast, the countries suffering from persistent problems in the real estate sector, weak industrial activity and a partly very restrictive budget policy stance remain in recession: Greece, for instance, saw GDP fall for the sixth consecutive time in the fourth quarter, to already 8 percent below the level recorded in the second quarter of 2009 (in real terms, seasonally adjusted). GDP has stagnated lately in Spain, Portugal, Ireland and Romania, and economic activity has been very weak also in Italy.

The international financial market and economic crisis caused unemployment to surge in the euro area; the situation in the labour market has not eased since then. In January 2011, the seasonally adjusted unemployment rate, at 9.9 percent of the labour force, was only 0.2 percentage point lower than the peak in October 2010 and 2.7 percentage points higher than the trough in February 2008. The economic recovery remains too weak to trigger an improvement in labour market conditions. However, the division of economic activity became apparent also in the job market: unemployment fell in the group of countries around Germany, while it remained extremely high in countries pursuing a particularly restrictive budget policy. In Spain it still exceeds 20 percent of the labour force.

Euro area inflation has risen markedly in recent months, reflecting price pressures in international commodity markets: in February, the HICP exceeded the year-earlier level by 2.4 percent, according to Eurostat's flash estimate. While the increase in the cost of energy has been the main determinant of price rises at the consumer level, higher food prices and, in some countries, the increase in value added tax rates have also been relevant. Inflation rates differ considerably across the euro area, ranging from a stable price level in Ireland to 5 percent in Estonia. Core inflation (increase in consumer prices excluding energy and unprocessed food), however, continues to be very low: recently it stood at 1.2 percent. Hence the cyclical price trend still remains well below the critical 2-percent mark.

Exports have been the engine powering the economic recovery in Austria. They have been rising vigorously since mid-2009, with real merchandise exports in the fourth quarter of 2010 posting an increase of 1.0 percent in seasonally adjusted terms from the previous quarter, and of 23 percent from the trough in the second quarter of 2009. Domestic export firms are benefiting from the brisk demand in world markets mainly through supplies to the German export industry. From January to November 2010, nominal exports to Germany rose by 17.2 percent compared with the same period a year before.

The brisk export demand is reflected in a strong increase in manufacturing production. In 2010 it exceeded the level in 2009 by 6.7 percent in real terms, according to national accounts data; in the fourth quarter, the expansion was 1.5 percent compared with the previous quarter, and 8.9 percent compared with a year before. The

Division of economic activity in the EU

EU countries with a competitive export industry are witnessing a noticeable expansion in GDP, and their unemployment rates are slowly falling. By contrast, those countries that are confronted with structural problems of competitiveness and in the real estate sector and pursue a particularly restrictive budget policy remain in recession.

Euro area: unemployment high, pick-up in inflation

The euro area unemployment rate remains close to its recession-related peak, reflecting overall weak economic activity. The inflation rate recently passed the 2-percent mark, mainly on account of higher energy prices; core inflation, however, remains low.

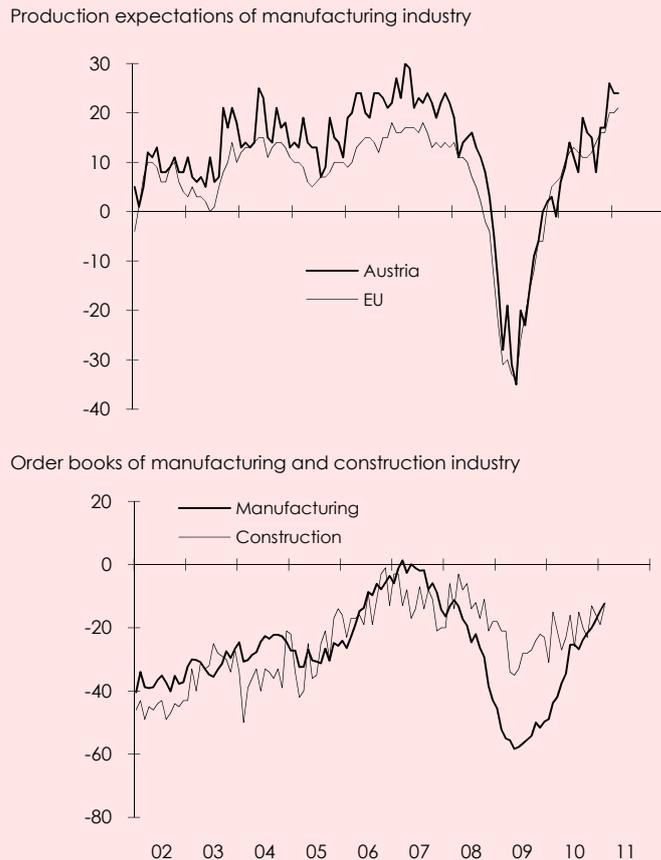
Upturn in industry continues

The strong expansion in world trade is reflected in buoyant industrial activity in Austria: notably the manufacturers of capital goods and motor vehicles are very optimistic also about the months ahead.

results of the WIFO business cycle survey of February are signalling that the upward trend observed in Austria's industrial sector will continue: production expectations reached a record high, with the balance of positive and negative responses coming in at +21 percentage points. Firms' assessment of order books and foreign orders improved further, and their appraisal of the business situation in six months suggests a continuation of the positive development. Activity is particularly buoyant in the sectors manufacturing capital goods and motor vehicles.

Figure 3: WIFO business cycle survey

Differences between the percentage shares of correspondents giving positive and negative replies, seasonally adjusted



Source: European Commission, WIFO business cycle survey.

At the beginning of 2010, equipment investment (machinery, vehicles and electrical appliances) witnessed a trend reversal, according to national accounts data. But its recovery has so far been sluggish. In the fourth quarter, real investment spending rose by 1.2 percent compared with the previous quarter. The year-on-year increase was 8.6 percent, in part also attributable to investments being brought forward in anticipation of the expiry of tax relief measures. Firms' readiness to invest in extension projects is improving in the face of satisfactory order books in industry and growing capacity utilisation.

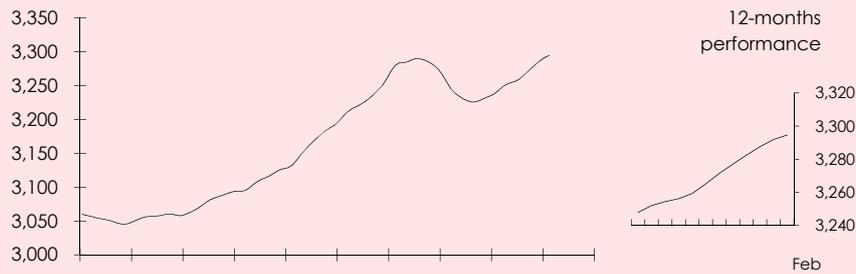
In construction, by contrast, a trend reversal is not in sight. The decline in construction investment continued unabated throughout 2010, according to national accounts data (fourth quarter 2010 -0.7 percent in real terms, quarter-on-quarter, -3.0 percent, year-on-year). Civil engineering firms are suffering from low capacity utilisation. Residential construction is registering a decline in the number of approved subsidised flats, particularly against the backdrop of budget consolidation efforts by the provincial governments.

Revival of equipment investment, continuing recession in construction sector

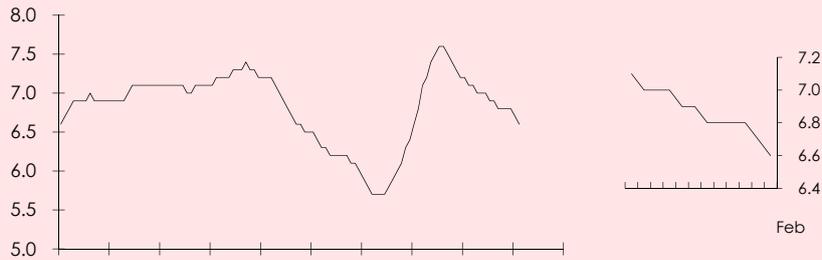
Rising capacity utilisation is causing a revival of equipment investment. By contrast, activity in the construction sector remains sluggish, also owing to austerity measures introduced by the government.

Figure 4: Key economic indicators

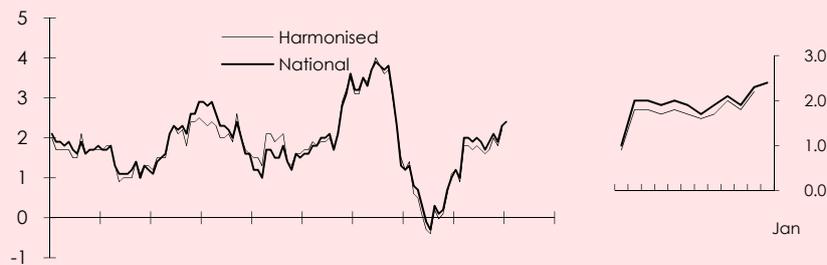
Persons in active dependent employment¹, (1,000), seasonally adjusted



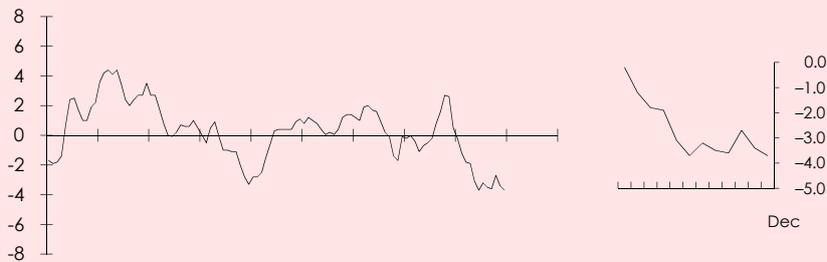
Unemployment rate, traditional Austrian method², seasonally adjusted



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.

*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.

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.itkt.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".

Private consumption has proved very steady also by international standards: during the recession it expanded by around ¼ percent in real terms, quarter-on-quarter, and has continued to grow at this pace also during the economic recovery. In the fourth quarter of 2010, the quarter-on-quarter rate of increase was 0.2 percent and the year-on-year rate was 0.7 percent. Hence consumer demand is now expanding

**Stable expansion of
consumer demand**

at a considerably slower pace than GDP. It was the only demand component that did not decline during the recession.

Retail sales developed favourably at the end of 2010 (December +2.7 percent in real terms, compared with a year before). Real retail sales for 2010 as a whole, adjusted for the different number of working days, rose by 2.1 percent compared with the previous year; this rate was well above the euro area average (+0.8 percent) or the rate recorded for Germany (+1.1 percent).

The inflation rate as measured by the consumer price index was 2.4 percent in January 2011. One third or more of the year-on-year price rise stemmed from higher prices for mineral oil products, which are in part a result of the increase in the mineral oil tax. The rise in the cost of energy was also reflected in an increase in housing expenditures. Higher food prices in world markets have been feeding through into consumer prices since the end of 2010: in January, food prices (including beverages) showed an increase of already 2.6 percent, contributing 0.3 percentage point to the inflation rate. Wholesale prices are rising at a considerably faster pace than prices at the consumer level (February +12.7 percent, compared with a year before).

In January, the Harmonised Index of Consumer Prices exceeded its year-earlier level by 2.5 percent. Hence the Austrian inflation rate was only marginally higher than the euro area average (+2.3 percent), but still clearly higher than the German rate (2 percent). The pick-up in inflation was accompanied by substantial losses in real wages: in January, the negotiated wage index rose by a mere 1.7 percent compared with a year before (excluding public employees, +1.9 percent).

The economic recovery is also reflected in the labour market: the number of persons in dependent active employment rose by 64,000 in February compared with a year before. This figure is still provisional, however, owing to adjustments to employment statistics. Adjusted for seasonal effects, the number of persons employed at the beginning of 2011 already exceeded the pre-crisis level.

By contrast, the number of unemployed persons was still substantially higher than before the crisis. On a seasonally adjusted basis, it stood at 241,000 in February, down 31,000 from the peak in August 2009, but still exceeding the trough in April 2008 by 36,000. The seasonally adjusted unemployment rate was 6.6 percent of the dependent labour force in February according to the traditional Austrian method of calculation, or 4.3 percent of the labour force according to Eurostat (January).

Private household expenditure – as is typical for a recovery phase – are growing at a considerably slower pace than GDP.

Pick-up in inflation largely due to energy prices

In January 2011, the inflation rate in Austria passed the 2-percent mark, a result of higher world market prices for crude oil and the increase in the mineral oil tax. But cyclical inflation remains subdued.

Recovery in labour market continuing

The economic upturn is reflected in the labour market: at the beginning of 2011, the seasonally adjusted number of persons employed already exceeded the pre-crisis level; the number of unemployed persons is still markedly higher, but it is also falling noticeably.