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Economic Activity Picking Up in Austria, Inflation Accelerating

Business Cycle Report of March 2017

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Austria's GDP increased at a quarterly rate of 0.5 percent in the fourth quarter. Hence the cyclical upswing observed in Austria proceeded. The forces driving the economy are robust and have so far rested on the domestic economy. The picture portrayed by leading indicators is improving further, suggesting that the cyclical upswing will proceed in spring 2017.

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Global economic growth (G-20 countries) is assumed to have been somewhat weaker in the fourth quarter of 2016 than in the previous quarter, notably owing to a slower expansion of US output. GDP growth in the EU remained robust at +0.5 percent in the fourth quarter of 2016. Among the five largest economies, Spain and the UK recorded the strongest expansion. In the other countries for which data are currently available, economic activity remained robust. Overall, global economic growth in 2016 was therefore similar to that in 2015. Hence the global economy remains on a steady path of expansion, which is also shown by the pick-up in industrial activity and strengthening international goods trade. Besides, prices have increased in important commodity markets. Moreover, the favourable picture portrayed by leading indicators suggests that global economic activity is gradually firming.

The Austrian economy is in a firm upswing phase. So far, lively domestic demand has been its key support: private consumption continued to grow vigorously also in the fourth quarter of 2016, in tandem with an increase also in public consumption. On the supply side, notably industrial activity has recently regained momentum. Following a phase of weakness in mid-2016, the expansion in the manufacturing sector accelerated markedly (fourth quarter +0.6 percent, after +0.4 percent in the third quarter). Market services are also supporting economic growth. The basic trend of economic activity in Austria continues to point upward, with the picture portrayed by leading indicators suggesting that the upswing will proceed in spring 2017.

Inflation in Austria has recently accelerated noticeably, in line with the cyclical upswing and the increase in commodity prices. In January 2017, annual CPI inflation was +2.0 percent (December +1.4 percent). Inflation as measured by the harmonised index was +2.1 percent, again clearly higher than the euro area average (+1.8 percent) and also higher than the German inflation rate (+1.9 percent). Employment continued to increase sharply also in February, with the seasonally adjusted number of persons in dependent employment rising by 5,200 compared with a month before, and by 57,000 or 1.7 percent compared with a year before, according to estimates by the Federal Ministry of Labour, Social Affairs and Consumer Protection (BMASK). The seasonally adjusted unemployment rate was 8.8 percent in January.

1. Global economic activity remains robust

Global economic growth (G-20 countries) is assumed to have been somewhat weaker in the fourth quarter of 2016 than in the previous quarter. The expansion slowed down particularly in the USA, while it remained robust in the other countries, according to data currently available. Overall, the growth rate of the global economy was therefore roughly in line with that of last year. Hence global activity is on a steady path of expansion, which is also confirmed by the favourable picture portrayed by leading indicators. According to Markit, the global manufacturing Purchasing Managers' Index rose further from an already high level in January and already exceeded the level recorded at the beginning of 2014. The Purchasing Managers' Index for the services industry indicates currently greater momentum in this sector than in manufacturing.

The favourable development of the global economy and the improvement of leading indicators have recently been increasingly reflected also in substantial price increases for important commodities. Rising commodity prices are expected to progressively provide expansionary stimulus especially to the economies of commodity-exporting countries in Latin America (Argentina, Brazil, Venezuela, etc.) and in the Middle East (Iran, Saudi Arabia, Kuwait) over the coming quarters.

Industrial production and – particularly in emerging market economies – goods trade have also increased considerably in recent months. CPB data, for instance, point to a noticeable acceleration of the expansion of these aggregates at the end of 2016. Hence the global economy proves to be extremely stable, despite considerable economic policy uncertainty.

1.1 Steady growth continues in China

Robust domestic activity is driving steady growth in China, which is set to proceed in spring 2017, according to leading indicators.

Economic growth in China was very stable throughout 2016. According to official estimates, real GDP, at +6.8 percent in the fourth quarter grew at roughly the same brisk pace as in each of the first three quarters (+6.7 percent). The growth momentum was largely driven by domestic activity. This is also reflected in a noticeable strengthening of imports. The picture portrayed by leading indicators is broadly optimistic, suggesting that the growth profile in spring 2017 will be similar to last year's. However, the outlook is darkened by the potential threat of the imposition of punitive tariffs on imports from China by the new US Administration. This poses downward risks for China, as these trade barriers would considerably dampen export demand.

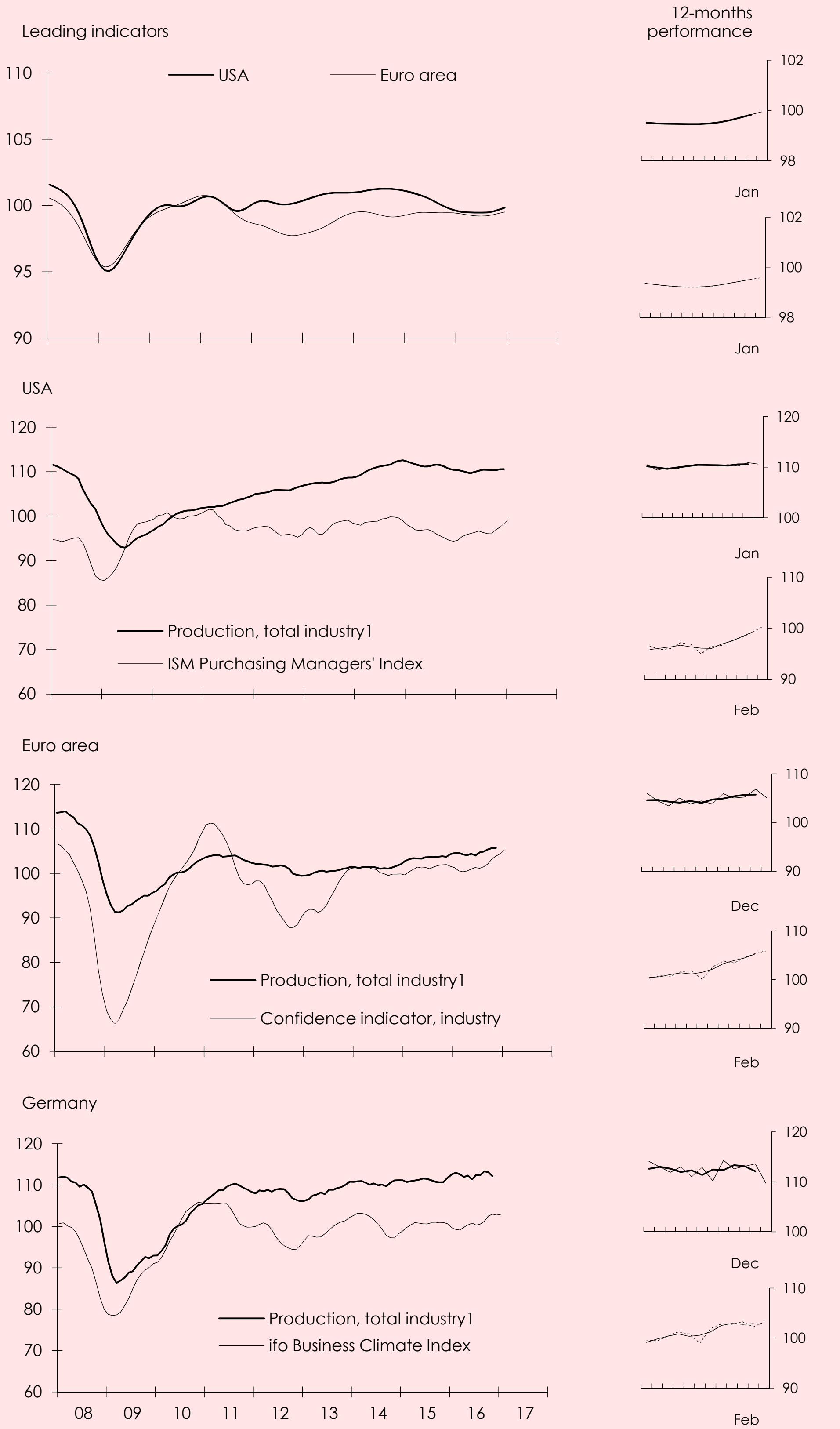
1.2 US growth is slowing

Inflation in the USA accelerated further, reaching 2.5 percent in January.

With GDP rising by 0.5 percent, the pace of the expansion in the USA decelerated noticeably in the fourth quarter compared with the previous quarter (+0.9 percent). However, developments in the second half of the year were nevertheless considerably better overall than in the first half. The slowdown was primarily attributable to external trade, notably exports, while domestic activity remained robust. Household consumption continued to grow vigorously also in the fourth quarter of 2016. The dynamism of domestic demand is now increasingly reflected in price developments; inflation rose for a sixth consecutive month in January (consumer price index December +2.1 percent, January +2.5 percent). It is now about as high as it was in spring 2012. As in previous months, price increases for energy were the key driver of accelerating inflation also in January. Core inflation (excluding food and energy) rose from 2.2 to 2.3 percent in January. House prices also rose vigorously; they have been on an upward trend since spring 2012. The unemployment rate, at 4.8 percent was in the lower range of current estimates of the natural rate of unemployment in January.

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.

Leading indicators have improved considerably lately as a consequence of expectations of a re-orientation of US economic policy. Notably the prospects of tax reductions and fiscal policy investment programmes may provide a boost to domestic activity as well as imports. Since the current GDP is now almost in line with the trend output, and the US economy has thus reached normal rates of capacity utilisation, these fiscal policy expansion plans may well further accentuate the inflation momentum. A potential increase in imports, by contrast, definitely entails considerable upward risks for the global trade in goods and hence also for global activity.

1.3 EU experiences robust expansion

GDP growth in the EU remained robust at +0.5 percent in the fourth quarter of 2016. Among the five largest economies, Spain and the UK recorded the strongest expansion (+0.7 percent each).

Overall, growth in the EU countries was remarkably stable in 2016 and essentially followed the trend observed in 2015. However, developments remained highly diverse across countries. A stabilisation of growth rates at high levels in Spain was followed by a marked deterioration of economic activity in Finland and once again in Greece towards the end of the year. Italy's economy continued to grow steadily, albeit at a sluggish pace. France registered a pick-up in economic activity in the second half of the year, while the growth momentum in Germany remained roughly stable, beyond the usual fluctuations of quarterly GDP data.

Leading indicators suggest that last year's favourable cyclical conditions are likely to persist. In February, the European Commission's Economic Sentiment Indicator (ESI) for the economic climate in the EU rose further (+0.3 points; UK +2.3 points, Spain +1.3 points, France +1.1 points, Italy +0.2 points, Netherlands +0.1 points, Germany –0.8 points). On euro area average, the ESI remained almost unchanged in positive territory in February, compared with a month before. Confidence indicators improved for manufacturing, services and construction and deteriorated for private consumption and retail trade.

The Purchasing Managers' Index for the euro area surged again in February, according to a flash estimate, to the highest level since April 2011, suggesting a further brightening in sentiment. Both the sub-index for the services sector and that for industry improved. A marked rise in the composite index was recorded for France and Germany. According to leading indicators, the solid growth seen in the euro area and in the EU as a whole is therefore likely to continue.

However, this favourable picture is darkened by numerous adverse developments in financial markets. For instance, the cost of financing government debt is increasing in the form of rising long-term interest rates. The high level of volatility seen last year in financial markets has somewhat flattened, but the prices of bank shares still remain below developments in overall indices. The ongoing problems in the European banking sector are currently reflected also in persistently high levels of systemic risk indicators for the financial sector as a whole. Last but not least, the surge in Target2 imbalances to levels hit before the outbreak of the European debt crisis points to rising financial market risks.

1.4 Pick-up in activity in East Central Europe

Economic activity picked up vigorously in East Central Europe at the end of 2016.

Economic activity accelerated markedly in East Central Europe as a whole at the end of 2016. Apart from Hungary and Slovakia, this was the case especially in Poland (fourth quarter +1.7 percent). Expansionary stimulus in the region was provided by robust domestic activity, but recently to a growing extent also by exports. Owing to the pick-up in activity, both the export demand from EU core countries and the deliveries to Russia increased again: according to a first estimate by the Statistics Service, Russia's real GDP is assumed to have contracted only slightly in 2016, following a drop of almost 3 percent in 2015. The Russian economy is assumed to have grown again noticeably in the second half of 2016, primarily as a result of the recovery in crude oil prices. In addition, numerous sentiment indicators improved markedly, notably consumer sentiment.

2. Upswing of Austrian economy

Economic activity in Austria gained momentum in the second half of 2016. The favourable picture portrayed by leading indicators suggests that this development will continue in spring 2017.

Austria's GDP grew by 0.5 percent, quarter on quarter, in the fourth quarter (trend-cycle component). Unadjusted GDP in the fourth quarter was 1.7 percent above its year-earlier level. The rate of change of seasonally and working day adjusted GDP according to Eurostat standard was +0.6 percent, somewhat higher than the euro area average (+0.4 percent) and the rate for the EU as a whole (+0.5 percent). Private consumption contributed substantially to GDP growth in 2016, owing to the improved income situation. In the fourth quarter, personal consumption expenditure (including that of private non-profit organisations) increased by 0.5 percent, while government expenditure, at +0.4 percent grew at a somewhat slower pace. Gross fixed capital formation (equipment and construction investment as well as investment in other fixed assets) stagnated in the fourth quarter, with the slowdown of activity in the construction sector dampening the result. Positive stimulus was still provided by investment in machinery and equipment (+0.5 percent): domestic companies once again stepped up their investment in machinery (+0.8 percent) and transport equipment (+0.5 percent). External trade, by contrast, remained sluggish. Goods exports stagnated of late, but services exports increased, with total exports consequently rising by 0.1 percent in the fourth quarter. Import demand increased by 0.3 percent (goods imports +0.2 percent). Net exports thus contributed again negatively to economic growth.

Industrial activity has recently regained traction. Following a phase of weakness in mid-year, the expansion in the manufacturing sector accelerated (fourth quarter +0.6 percent, after +0.4 percent in the third quarter). Market services also supported economic growth; value added increased by 0.5 percent each in trade and in the hotels and restaurants sector. Construction activity, by contrast, slowed (–0.2 percent).

2.1 Sentiment brightening further

The picture portrayed by leading indicators is improving further on a broad basis. Austrian companies in the individual sectors assess the outlook for economic activity positively.

The results of WIFO's February Business Cycle Survey show a further improvement in Austrian companies' already favourable assessments of economic conditions. The sub-index for construction rose to 22.8 points, signalling highly optimistic sentiment. Assessments of the situation by businesses in the manufacturing and services sectors were unchanged. The sub-indices remained in clearly positive territory. Companies' business expectations, after deteriorating a month earlier, improved again, reaching a level unseen since March 2011. Assessments followed divergent patterns across sectors: the expectations index stagnated in construction, but at +7.2 points remained clearly in positive territory. In manufacturing, already very positive economic expectations improved further. The increase was somewhat more marked in the services sector, where the index reached its highest level since spring 2011, signalling a highly optimistic outlook for economic activity.

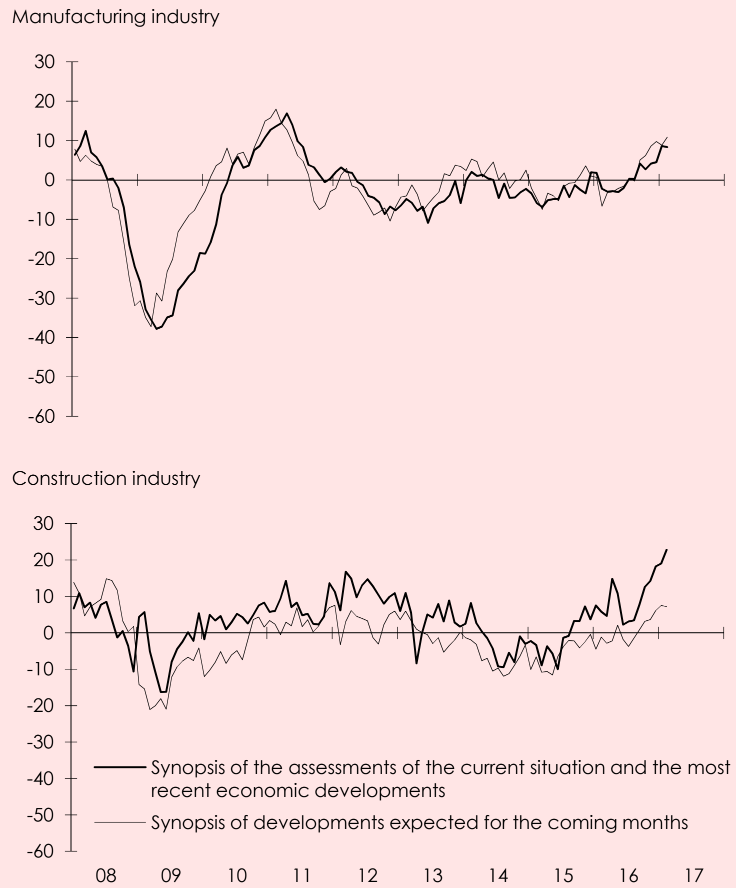
The Bank Austria Economic Indicator has also been moving upward for several months now and recently reached its highest level since the summer of 2011, signalling strong growth of the Austrian economy at the beginning of the year. Rising optimism in the services sector had the biggest influence on the overall result of the indicator in January. In addition, the positive development observed in the construction sector and improving consumer confidence also point to robust domestic demand.

The Bank Austria Purchasing Managers' Index stagnated in February, but at 57.2 points indicated lively economic activity. Its course was determined by the consistently favourable development of new business. New orders increased markedly notably in the intermediate goods sector, while a further pick-up in demand was also registered for investment goods and consumer goods.

In the current analysis, the WIFO Leading Indicator rose further on a month-on-month basis, albeit at a weaker pace than in the previous two months. The upward movement was determined by domestic sub-indicators, while among foreign sub-components especially industry-related indicators exerted a dampening effect.

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.

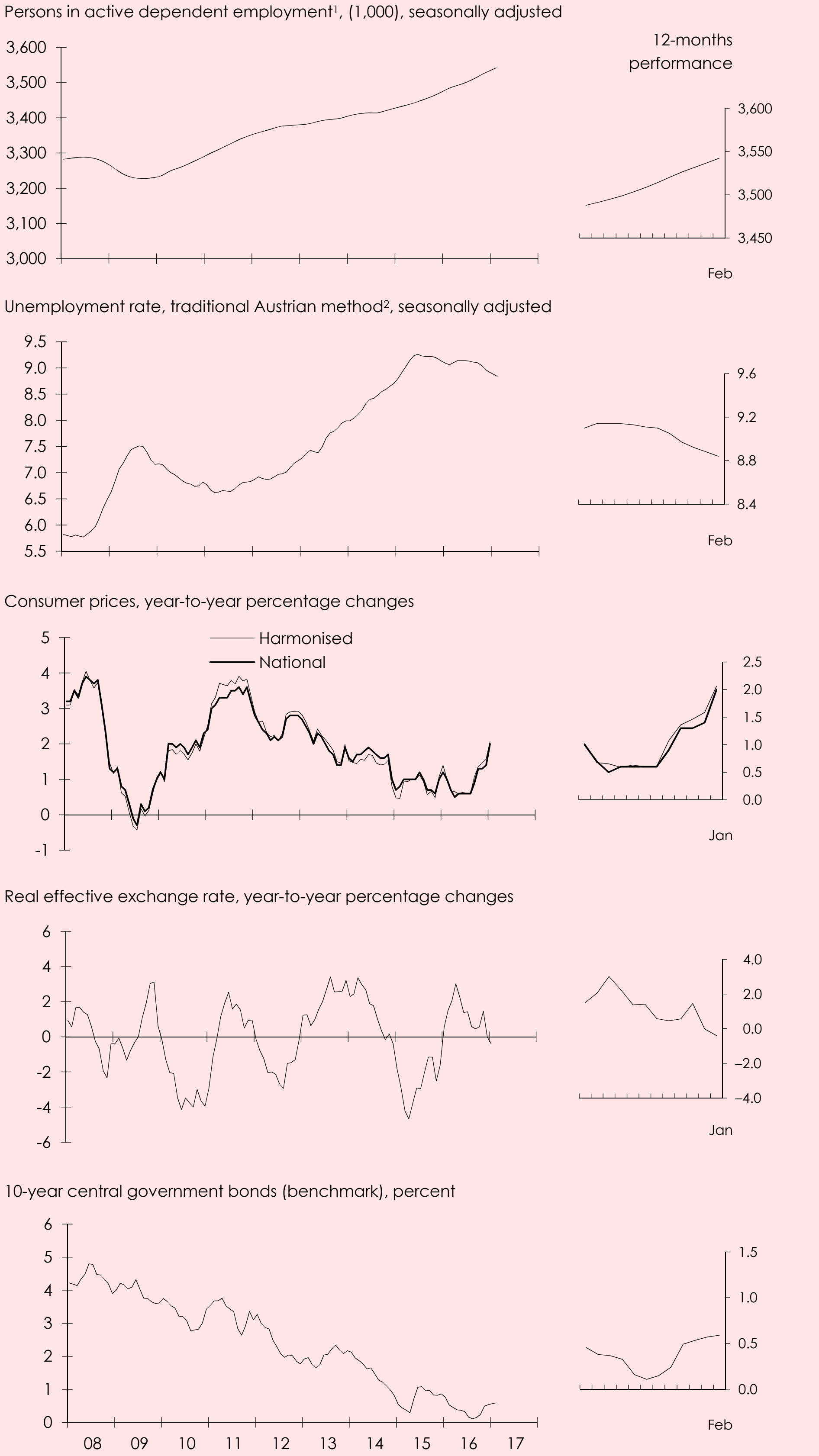
2.2 Tourism sales below year-earlier level in winter season so far

In the first half of the 2016-17 winter season, the Austrian tourism industry recorded a slight sales decline of 0.2 percent in nominal terms to 5,86 billion €, according to estimates by WIFO. Adjusted for price changes, revenue was down by 1.8 percent compared with a year before; the "real expenditure per night spent" quality indicator also decreased.

The number of nights spent from November 2016 until January 2017 totalled 29.03 million, a decline by 1.0 percent from a year before. Overall, the development of domestic demand (–0.9 percent) was similar to that of foreign demand (–1.0 percent); however, the picture was different in January (domestic guests –4.8 percent, foreign guests +4.0 percent). The number of arrivals, by contrast, reached a new peak (total increase +0.4 percent, to 8.60 million), with the average length of stay thus declining by 1.4 percent (domestic guests +0.6 percent).

The highest increase in the number of nights spent was registered for travellers from the USA (+8.6 percent), Poland (+8.3 percent; at +40,600 the highest absolute increase) and Switzerland (+3.3 percent). While the demand from the UK (+0.9 percent) slightly exceeded the level recorded for the same period a year before, the number of nights spent declined marginally for guests from Russia (–0.6 percent) and noticeably for travellers from the Czech Republic (–1.3 percent). A substantial decline was recorded above all in the number of nights spent by guests from Germany (–3.3 percent), followed by those from the Netherlands (–5.2 percent), the second-most important source market. The demand from Italy (–6.5 percent) and Belgium (–8.9 percent) remained far below their year-earlier levels.

Figure 3: Key economic indicators



Source: Public Employment Service Austria, Federation of Austrian Social Security Institutions, Oesterreichische Nationalbank, Statistics Austria, WIFO calculations. – [1] Excluding persons with valid employment contract receiving child care benefit or being in military service. – [2] As a percentage of total labour force excluding self employed, according to Public Employment Service.

2.3 Inflation accelerated significantly in January

Inflation in Austria accelerated significantly in January, driven by the marked increase in energy prices.

Inflation as measured by the consumer price index reached 2.0 percent in January 2017 (December 1.4 percent), the highest reading since July 2013 (+2.0 percent). Price dynamics were strongest in the "transport" expenditure group, with an average annual price increase of +4.2 percent: fuel prices were up by 14.3 percent from a year before in January 2017 (December 2016 +3.9 percent). Owing to the statistical base effect (price decline in same year-earlier period), fuels thus became the main price booster.

In the "housing, water, energy" category, price increases averaged 1.7 percent. Apartment rents rose by 4.3 percent, while apartment maintenance costs increased by 1.4 percent on average. The drastic increase in heating oil prices compared with a year before (+32.7 percent, December 2016 +15.3 percent) was almost completely offset by price declines for other energy sources (solid fuels –2.1 percent, gas –3.3 percent, electricity –5.5 percent); consequently, prices of household energy overall were up by 0.6 percent on average compared with a year before.

Inflation as measured by the harmonised index of consumer prices reached +2.1 percent in January 2017.

The harmonised inflation rate was +2.1 percent in January (December +1.6 percent); the deviation of +0.1 percentage point between HICP and CPI is due to a different weighting of components. Upward price pressures in the "restaurants and hotels" as well as "fuels" expenditure categories (components in both categories having higher weights in the HICP than in the CPI) increased the HICP compared with the CPI. Inflation as measured by the HICP, at +2.1 percent in January exceeded the euro area average (+1.8 percent). The spread between inflation rates remained high: for instance, inflation was low in Ireland (+0.2 percent), but extraordinarily high in Belgium (+3.1 percent).

2.4 Labour supply growing briskly

Employment growth proceeded also in February. Especially the employment of Austrian citizens increased again markedly.

According to estimates by the Federal Ministry of Labour, Social Affairs and Consumer Protection (BMASK), employment grew further in February 2017 (+5,200, month on month, seasonally adjusted, provisional year-on-year increase +57,000 or +1.7 percent). The number of persons unemployed (excluding persons in training) fell marginally compared with a year before (–5,100, January –2,700). The last-recorded number of persons registered as unemployed was about 351,700 (seasonally adjusted). The seasonally adjusted unemployment rate stood at 8.8 percent (national definition).

The leading indicators for the labour market signal persistently positive developments in the demand for labour. The manpower requirement of industrial firms, for instance, may increase further in the coming months. This is suggested by the high level of the sub-indicator for employment of the Bank Austria Purchasing Managers' Index. With economic activity accelerating, the number of vacant jobs registered with the Public Employment Service is also on the rise. But since the brisk growth in labour supply continues unabated, unemployment is declining only little, in spite of the favourable economic development.