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Vigorous Economic Activity in Winter 2017-18

Business Cycle Report of December 2017

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Both the global and the Austrian economy are growing vigorously at present. Sentiment indicators suggest that this momentum will continue also in the first few months of the coming year. This benefits the Austrian labour market, although the unemployment rate remains high. Inflation in Austria exceeds the euro area average.

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Global economic activity remains robust and is likely to maintain momentum also through the first few months of the coming year. In the USA, the economy grew at a brisk quarter-on-quarter pace of 0.8 percent in the third quarter. Industrial production increased in October, and continuing extremely positive consumer sentiment points to ongoing lively private consumption in the coming months.

This is also supported by the favourable situation of the US labour market. The unemployment rate declined to 4.1 percent in October, the lowest level in more than 15 years. The economic upswing also benefits long-term unemployed persons, underemployed part-time workers and other persons on the edge of the labour market. However, the persistently low labour force participation rate and the absence of wage pressures suggest that there is still spare capacity in the labour market, despite the low unemployment rate.

Euro area GDP advanced at a seasonally adjusted quarter-on-quarter rate of 0.6 percent in the third quarter. The robust growth was broad-based across almost all countries. Assessments of current developments and the outlook for the coming months also improved in November and are extremely positive, according to the European Commission's business survey. Hence the robust activity is set to continue in the euro area. The labour market situation improved further in October; but at 8.8 percent, the unemployment rate is still 1½ percentage points above its pre-crisis level. This dampens wage developments; as a result, inflation (+1.5 percent in November, according to first estimates) has not accelerated so far.

The Austrian economy is also growing at a brisk pace last seen seven years ago. GDP advanced by 0.9 percent, quarter on quarter, in the third quarter. Moreover, businesses' assessments of the present situation improved further in November, and the outlook remains extremely positive, according to the WIFO-Konjunkturtest (business cycle survey). This points to continued robust economic activity in the first half

of 2018. The investment momentum weakened somewhat in the third quarter, however, after two years of sharp increases.

The labour market also benefits from the vigorous economic activity. Employment growth continued unabated in November (+2.3 percent, compared with a year before). Thus the seasonally adjusted unemployment rate dropped to 8.2 percent (-0.8 percentage point, compared with a year before). Nevertheless, it remains considerably higher than before the financial and economic crisis.

CPI inflation stood at 2.2 percent in October, and was markedly higher than the euro area average. Particularly sharp price increases were registered for food, catering services, housing rents and, surprisingly, some industrial goods. The core inflation rate was +2.3 percent in October, compared with a year before.

1. No signs of slowdown in activity in the USA

Global economic activity remains robust and is likely to maintain momentum also through the first few months of the coming year. Almost all important export countries of Austrian companies experienced strong economic growth in the third quarter. According to current economic indicators, the expansion is expected to maintain this pace until year-end and beyond.

In the USA, GDP grew briskly at +0.8 percent, quarter on quarter, in the third quarter. Growth was supported by lively domestic demand, and especially by private consumption and investment. However, inventory accumulation contributed considerably to output growth. Export momentum, by contrast, slowed somewhat.

Economic indicators in the USA reflect the optimistic assessments by businesses and private households. The ISM Purchasing Managers' Index and the Consumer Confidence Indicator did decline slightly in November compared with the previous month, albeit remaining at high levels. By contrast, consumer sentiment according to the Conference Board improved noticeably. The expansion of industrial production in October also points to a continuation of the positive economic momentum.

The vigorous economic upswing led to an improvement in labour market conditions. In October, the unemployment rate fell to 4.1 percent, the lowest level in more than 15 years, and about 6 percentage points below the peak level recorded eight years ago (Figure 1). The number of long-term unemployed and the unemployment rate including underemployed part-time workers and persons on the edge of the labour market (U-6) also declined. At 7.9 percent, it was as low as before the 2007-08 financial crisis. Thus the labour market recovery has already progressed considerably. However, the labour force participation rate is 4 percentage points lower than the rate for 2007, and has barely been rising so far. Hence there is still some spare capacity in the labour market.

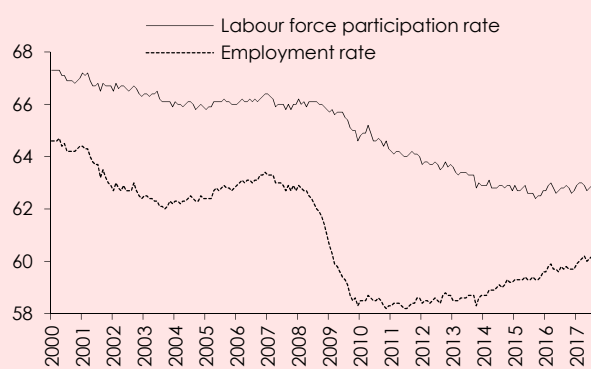
The US unemployment rate fell to its lowest level in more than 15 years. Activity is set to remain vigorous in the coming months.

Figure 1: Unemployment and labour reserves in the USA

Percentage of labour force, seasonally adjusted



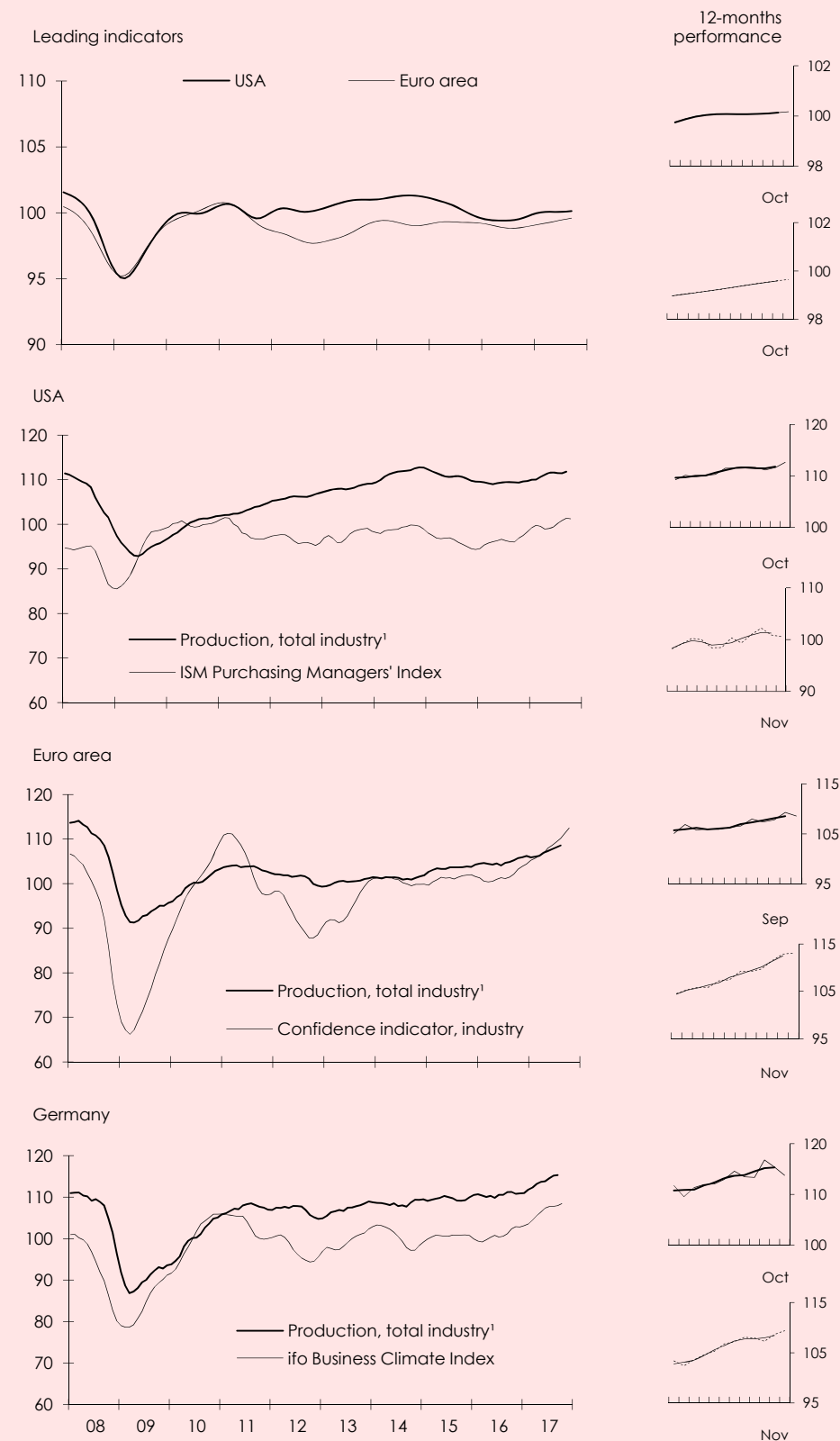
Percentage of population (16 years and over), seasonally adjusted



Sources: Bureau of Labor Statistics (BLS), Macrobond. Special unemployment rate U-6, according to BLS: including underemployed part-time workers and persons who are not seeking work or are not immediately available.

Figure 2: International business climate

Seasonally adjusted, 2010 = 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.

This becomes apparent also in the development of average wages per hour in the private sector, the growth of which has not picked up since mid-2016. Inflation has not accelerated so far, with the consumer price index exceeding the year-earlier

level by 2 percent in October. Core inflation (consumer prices excluding food and energy) was also moderate at +1.8 percent.

2. Marked surge in stock prices

The most recent price development observed in stock markets is remarkable. At the beginning of December, the S&P 500 Index for the USA surpassed the level recorded in 2007 by about 70 percent. Since the presidential election in November 2016 it has risen by approximately 25 percent. This in part likely reflects higher profit expectations on account of the corporate tax cut announced by President Trump. However, this trend has persisted for quite some time now and can also be observed for stocks outside the USA. Hence the possibility of a stock price correction cannot be ruled out for the near future. US real estate prices are in fact also higher again than in 2007, according to the S&P/Case-Shiller Index, but they are rising at a considerably slower pace than stock prices. However, unlike before the 2007-08 financial crisis, the household debt to GDP ratio has barely increased so far in the USA.

The risk of a stock market correction is increasing. US real estate prices are rising less sharply, and household debt growth has been subdued so far.

3. Broad-based economic upswing in euro area

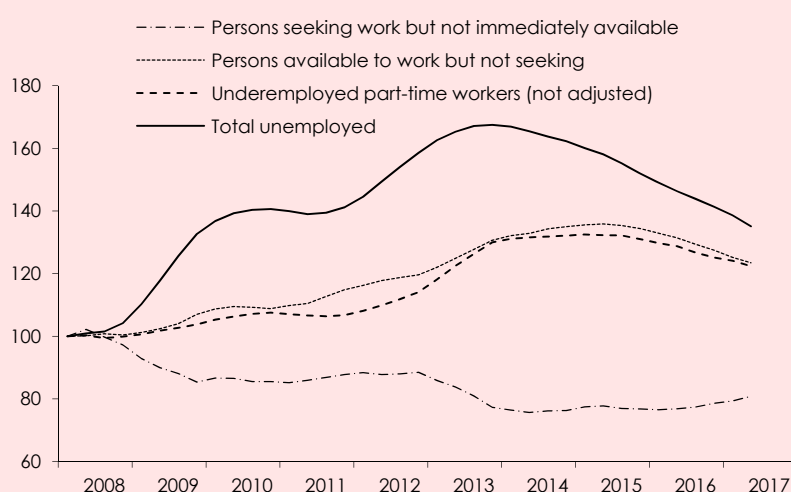
Euro area GDP rose at a quarter-on-quarter rate of 0.6 percent, seasonally adjusted, in the third quarter. Almost all countries experienced robust growth. At +0.8 percent, the German economy expanded at a particularly brisk quarter-on-quarter pace. But France (+0.5 percent) and Italy (+0.4 percent) also registered a relatively substantial increase in GDP.

Assessments of the present situation and the outlook for the coming months are also very positive, according to the European Commission's business survey; they improved further in November. The Economic Sentiment Indicator (ESI) rose to its highest level since 2000 in the euro area. Firms in industry assessed developments of order books, production and employment more positively than they did a month before, and consumer confidence also brightened. The breadth of the upswing is apparent also here – sentiment is extremely positive in all countries of the euro area.

The upswing in the euro area is broad-based, with strong economic growth observed in almost all countries. Sentiment remains positive, and unemployment is declining. However, there is still ample spare capacity in the labour market.

Figure 3: Labour reserves in the euro area

First quarter of 2008 = 100, 4-quarter moving average, seasonally adjusted



Source: Eurostat.

The robust economic activity has been reflected in the labour market for quite some time. The unemployment rate dropped to 8.8 percent, seasonally adjusted, in October, its lowest level in almost eight years. Underemployment (underemployed part-time employment) and the number of persons who have temporarily stopped look-

ing for work, have also already declined markedly (Figure 3). But the labour reserves are even more marked in the euro area than in the USA. The unemployment rate, for instance, still stands around 1½ percentage points above the level recorded prior to the economic crisis. Should the downward trend observed in the course of 2017 continue, the pre-crisis level is expected to be reached by the end of 2018. But in some countries, the unemployment rate is still very high and even further away from its respective pre-crisis level than on euro area average.

These reserves are likely to have contributed to keeping wage growth subdued so far, despite the significant improvement in the labour market. This is reflected in a persistently low inflation rate. In November, the Harmonised Index of Consumer Prices (HICP) stood 1.5 percent above its year-earlier level, according to the first estimate; core inflation (HICP excluding energy and unprocessed food) was even lower at +1.1 percent.

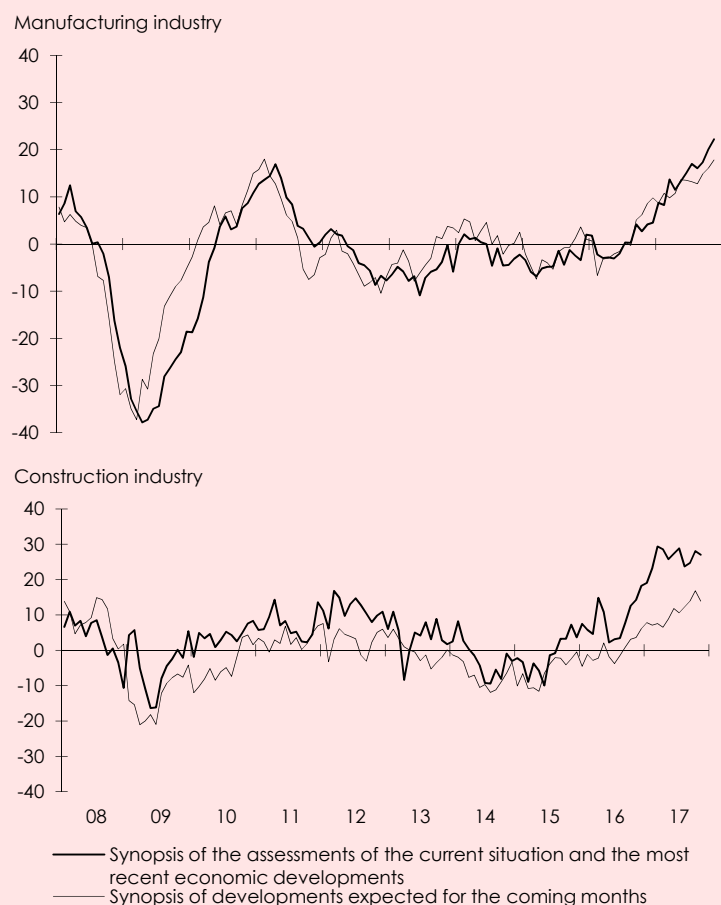
4. Robust third-quarter growth of Austrian economy

Economic activity has remained buoyant also in Austria in the second half of 2017. In the third quarter, seasonally adjusted GDP (trend-cycle component) advanced by 0.9 percent, quarter on quarter. Hence aggregate production was up by 3.2 percent compared with a year before. The sharp expansion was broad-based across all major economic sectors. Notably manufacturing recorded brisk value added growth (+2.9 percent, quarter on quarter).

Economic activity in Austria is supported by the favourable development of the global economy and by dynamic domestic demand. Evidence from the WIFO-Konjunkturtest (business cycle survey) points to a continuation of the upswing in the first few months of 2018.

Figure 4: Results from the WIFO-Konjunkturtest

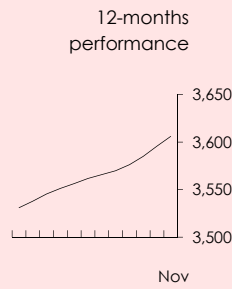
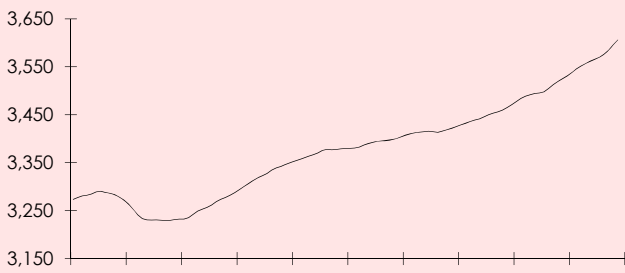
Indices of the assessment of the current economic situation and of business expectations, seasonally adjusted



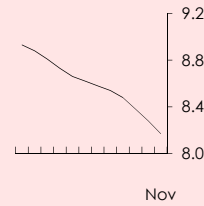
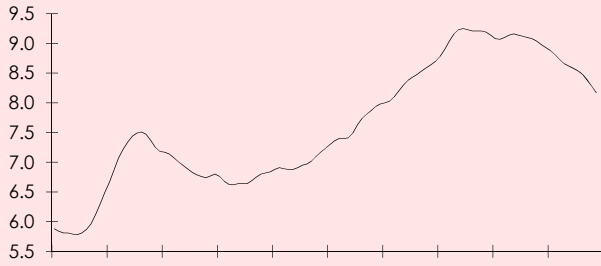
Source: WIFO-Konjunkturtest. Data refer to index points (percentage points) between +100 and -100. Values above 0 imply positive expectations, values below 0 indicate negative expectations.

Figure 5: Key economic indicators

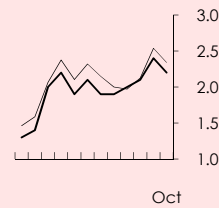
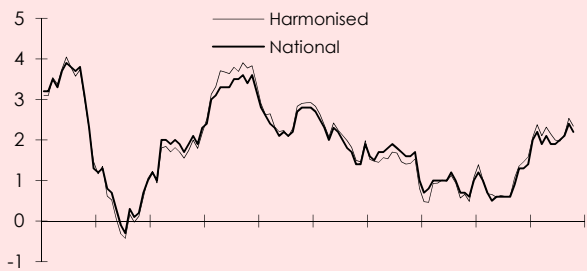
Persons in active dependent employment¹, 1,000s, seasonally adjusted



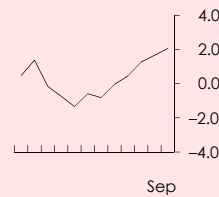
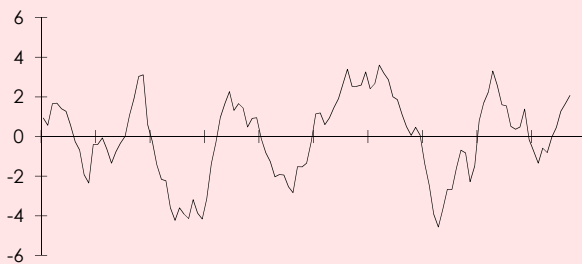
Unemployment rate, traditional Austrian method², seasonally adjusted



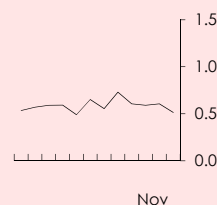
Consumer prices, year-to-year percentage changes



Real effective exchange rate, year-to-year percentage changes



10-year central government bonds (benchmark), percent



Source: Public Employment Service Austria, Main Association of Austrian Social Security Institutions, Oesterreichische Nationalbank, Statistics Austria, WIFO calculations. – ¹ Excluding persons in 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.

The expansion was mainly driven by an increase in private consumer spending and gross capital formation. However, part of the investment growth was attributable to inventory accumulation; growth in gross fixed capital formation, by contrast, moderated somewhat. In particular machinery and equipment investment appears to be losing some momentum now, after two years of vigorous increases. Construction investment grew at a considerably slower pace in the third quarter than in the first half of the year, and foreign trade also lost momentum.

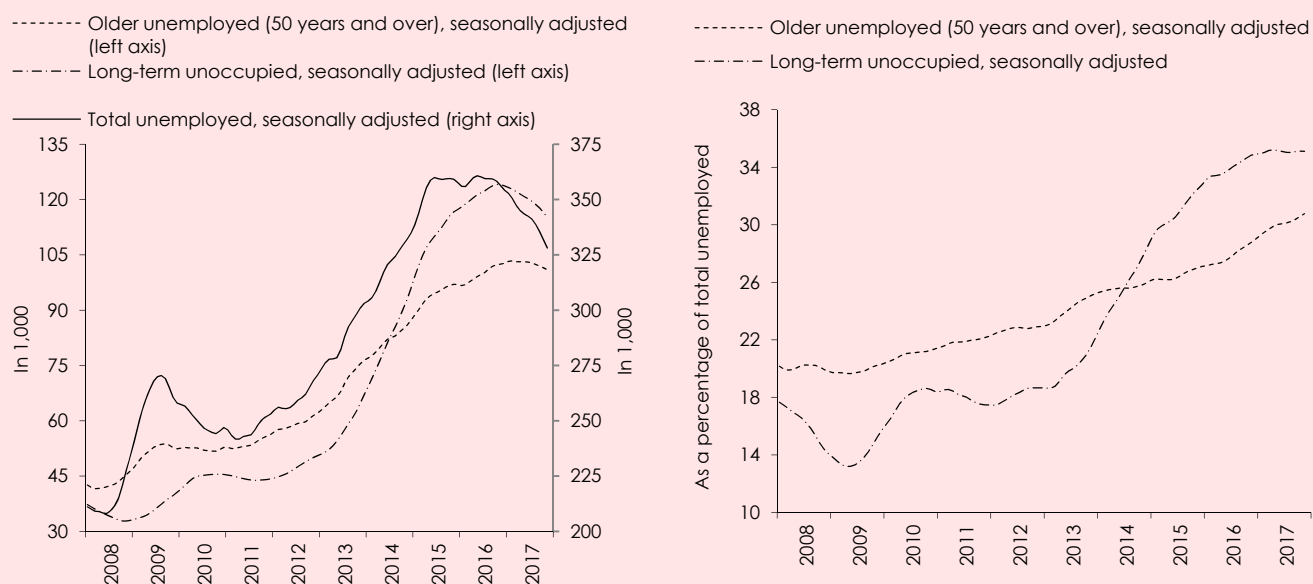
Nominal Austrian exports were still 8.5 percent higher in August than a year before, according to foreign trade statistics. Accumulated exports in the first eight months of 2017 exceeded the year-earlier level by 8 percent. Almost all exports increased, with the exception only of accumulated exports to Switzerland and the UK, which declined considerably compared with a year before. Apparently this reflects the subdued economic growth in Switzerland on the one hand, and uncertainty and dampened expectations owing to the UK's announced exit from the EU on the other.

4.1 Economic outlook remains extremely positive

The latest economic indicators point to continued buoyant activity in the fourth quarter of 2017. According to the WIFO-Konjunkturtest, companies are still extremely optimistic in their assessment of both the present situation and the development in the next few months. The Present Situation Index rose further, reaching a record high in November. It improved markedly notably in manufacturing. Firms in construction and in the services sector continue to assess the present situation very positively, but their assessments have remained broadly unchanged already for several months, however.

Austrian companies also remain highly optimistic regarding their future business situation. The expectations index for the economy as a whole did decline slightly in November, however, according to the WIFO-Konjunkturtest. By contrast, the outlook improved once again in manufacturing, with positive assessments concerning all sub-sectors. Consumer confidence was also high in November, according to the European Commission's Consumer Survey. All this points to continued robust activity in the first half of 2018.

Figure 6: Unemployment in Austria



Source: Public Employment Service Austria, WIFO calculations. Long-term unoccupied: registered with the Public Employment Service Austria (AMS) for more than a year. This definition, in contrast to "long-term unemployment" as reported e.g. by Eurostat, not only includes registered unemployment but also other preregistration states such as seeking apprenticeship, in training, check of work ability and others. All such successive episodes (regardless of interruptions of 62 days or less) are merged into a single business case. If the business case duration exceeds 365 days, the respective person is classified as "long-term unoccupied".

4.2 Big reserves in labour market

The vigorous economic activity is having a positive impact on the Austrian labour market. In November, the number of persons in active dependent employment rose by 81,000 (+2.3 percent), compared with a year before, according to preliminary estimates. Compared with the previous month, the seasonally adjusted increase was 10,400 (+0.3 percent). Hence employment continued to increase at a brisk pace, broadly similar to that recorded in the previous month.

In November, the number of persons registered as unemployed with the Public Employment Service Austria (AMS) declined by 28,800 (–8.1 percent), year on year; including persons enrolled in training programmes, it fell by 24,400 (–5.7 percent). Thus the seasonally adjusted month-on-month decline was 1.1 percent. The seasonally adjusted unemployment rate fell from 8.3 percent in October to 8.2 percent in November; compared with a year before, the decline was 0.8 percentage points. A particularly sharp decline was registered in the number of unemployed young people (–17.1 percent, compared with a year earlier). Unemployed older persons (–2 percent) and long-term unemployed (–2.8 percent) as well as unemployed persons with health problems (+0.6 percent) have so far benefited less from the increase in the demand for labour (Figure 6).

4.3 Substantial price increases in some sectors

Annual (CPI) inflation, at 2.2 percent in October, was noticeably higher than the euro area average (HICP Austria +2.3 percent, euro area +1.4 percent). Particularly sharp increases were registered in the prices of food, catering services, housing rents and non-energy industrial goods such as appliances for audio-vision, photography and data processing. The prices of the latter, after rising only moderately until August, increased unexpectedly briskly especially in September and October. The price index for the micro basket of goods (daily purchase) rose by 5.7 percent compared with a year before, while that for the weekly purchase increased by 3.4 percent. The (CPI) core inflation rate was +2.3 percent in October.

The buoyant economic activity fuels an improvement in labour market conditions. The unemployment rate is falling noticeably, albeit remaining high.

Inflation in Austria exceeds the euro area average. Notably price developments for food, catering services, apartment rents and some industrial goods are exerting upward pressure on prices.