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Industry's Assessment of the Future Stabilises

Business Cycle Report of March 2019

Industry's Assessment of the Future Stabilises. Business Cycle Report of March 2019
The assessment of future economic development by Austrian industrial companies did not deteriorate further in February, optimistic and pessimistic assessments now almost balance each other out. Against the backdrop of weak world trade, there are also positive economic signals: in Germany, the situation in the automotive sector appears to be stabilising and the trade conflict between China and the USA is easing.

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In China, the economy cooled down, but did not drop. Large losses in value added were recorded especially in those sectors and product groups affected by the US tariff increases. Overall, however, global trade growth slowed noticeably in recent months. At the same time, the domestic economic forces in the major economies are very diverse. In the USA, the investment boom continued, a large part of which is attributable to the tax reform, in particular the temporary limitation of generous depreciation rules and the associated pull-forward effects. In Germany, on the other hand, whose economy is already much more dependent on world trade than that of the USA, the trade slackness was intensified by distortions in the automotive sector. However, the quarterly accounts signal an improvement in this area: the high inventories that had arisen in the third quarter because registrations had faltered were partially reduced in the fourth quarter. Obviously, the certification backlog is gradually dissolving.

In Austria, too, the economy is getting under the influence of the global trade slump, although exports still grew relatively fast in the fourth quarter of 2018. On the other hand, the expansion of domestic investments and the production of goods weakened more strongly. Supported by demand for construction and services, however, the Austrian economy grew quite robustly overall. The picture deteriorated somewhat at the beginning of 2019: the otherwise buoyant growth of the tourism industry was dampened in January because the heavy snowfall prevented day visitors from visiting the winter sports regions. The winter weather is also likely to have had an above-average negative impact on other sectors, such as in construction, and contributed to the slowdown in the decline in unemployment. The situation improved in February and the number of unemployed fell more rapidly again. The assessment of future economic development by industrial companies stabilised, optimistic and pessimistic valuations now more or less balance each other out. The sentiment among service providers is still relatively optimistic. The inflation rate recently dropped to 1.7 percent. The pressure on fuel prices, caused by the small oil price shock in the run-up to the Iran sanctions in autumn 2018, has eased.

1. More expansive economic policy in China

The Chinese economy is weakening, but not as abruptly as in 2015.

The slowdown in economic growth in China has attracted increasing attention in recent months. Purchasing Managers' Indices are predominantly pessimistic, and real growth in value added in industry, including construction, and the economy as a whole is slowing. By contrast, foreign trade, which had already been affected by US customs measures at the end of 2018, recovered in January (although special effects in connection with the Chinese New Year festival cannot be ruled out). However, real indicators, in particular value added, only provide a limited picture of the actual economic situation as they are not very valid for political reasons. Nominal values often provide better clues. Growth in industrial production slumped from 2015 (+6 to +7 percent year-on-year and at current prices) to temporarily below 2 percent. This sharp decline was related to economic policy measures taken to curb the shadow banking system. From the end of 2016, however, industrial production recovered rapidly and grew in the first quarter of 2017 by more than 13 percent year-on-year and at current prices. Since then, nominal growth has weakened, but was still 10 percent in the fourth quarter of 2018. Since commodity prices have fluctuated strongly in recent years, nominal values are certainly not a perfect economic indicator either. However, they do provide valuable information that is not apparent in real terms due to inadequate deflation.

All in all, an economic slowdown can be observed at the moment, but not an economic slump as in 2015. Economic policy recently responded with a number of expansionary measures. In the first week of January, the central bank announced a reduction in minimum reserve requirements. The central government allows local governments to bring forward part of the annual debt tranche in order to finance infrastructure projects more quickly. The planning authority also approved rail infrastructure projects worth 125 billion $, 40 percent more than in the previous year.

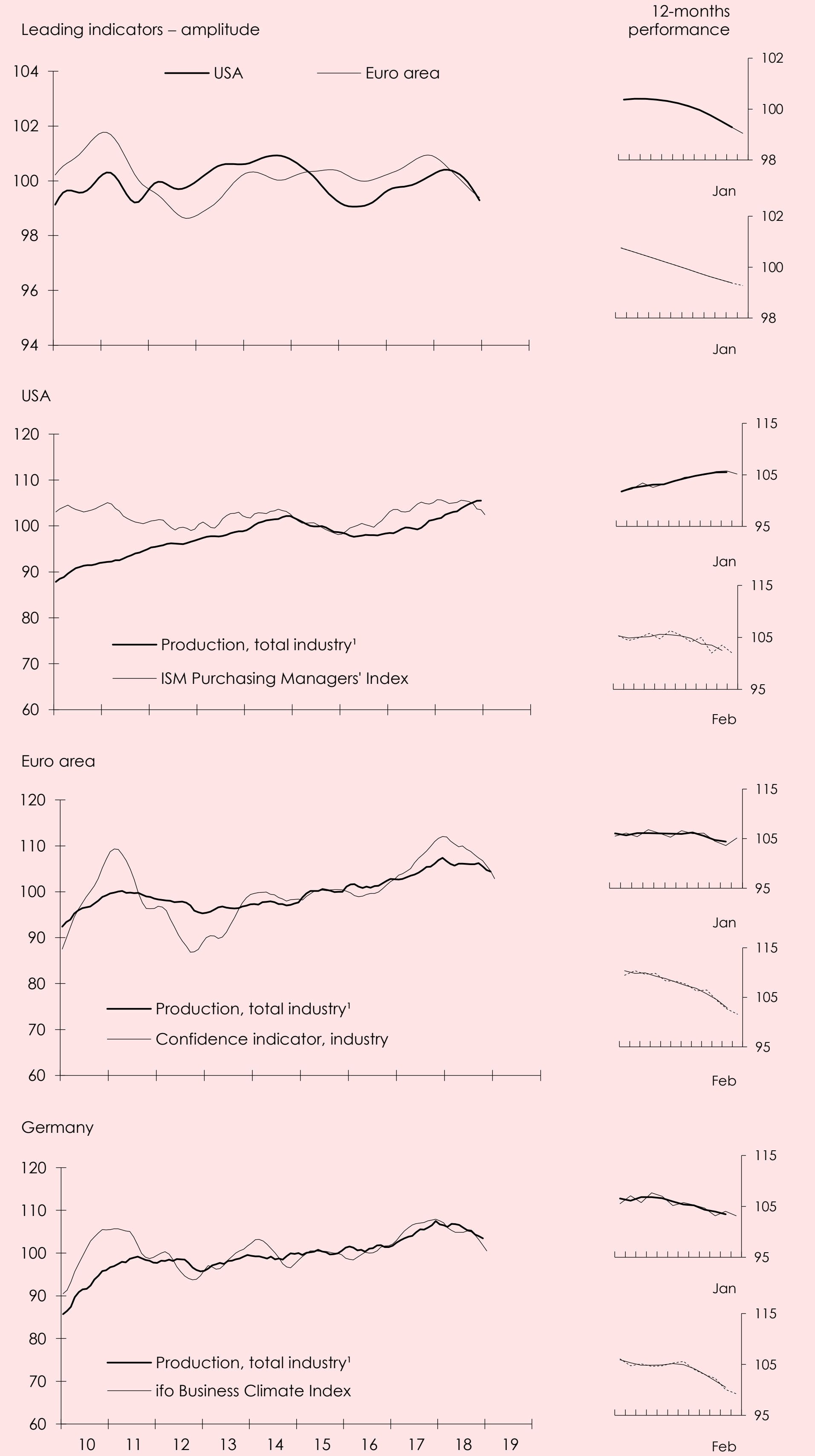
2. Trade dispute between China and the USA eases

On February 24, President Trump announced that because of "substantial progress on key structural issues such as intellectual property protection, technology transfer, services, currency and many others" there would be no further increases in tariffs on Chinese goods for the time being; an increase from 10 to 25 percent for imports worth 200 billion $ had previously been in the pipeline. The next step will be to work out a comprehensive agreement between the USA and China.

In some fields an agreement will be relatively easy. China agreed to purchase significant amounts of energy and agricultural products, in particular soybeans, from the USA in order to reduce bilateral trade imbalances. The US request to strengthen intellectual property protection and to omit from currency devaluations should be met. In other fields, agreement is more difficult to reach. This applies in particular to a change in China's industrial policy, which the USA is pressing for. However, China considers this as at the heart of its development strategy. A lasting de-escalation of the trade conflict will continue to depend on the political intentions of the USA. The fundamental tensions regarding technology transfer, industrial policy and China's rise in general are unlikely to ease in the near future and the tariffs that have been introduced so far will remain.

Figure 1: International business climate

Seasonally adjusted, 2015 = 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.

3. Growth in the USA favoured by tax reform

Investments in the USA will be partly brought forward in order to take advantage of the temporary early depreciation.

The Bureau of Economic Analysis, the statistical office of the USA, delayed the publication of the current national accounts by one month due to the administrative standstill. GDP growth slowed somewhat in the fourth quarter of 2018, but remained strong at 0.6 percent compared to the previous quarter. Investments, especially in machinery and equipment, expanded rapidly again and compensated for the decline in the growth contribution of private consumption. The investment boom has been fuelled by the corporate tax reform in force since the beginning of 2018 and, above all, by the expansion of depreciation regulations. The temporary nature of these measures is triggering pull-forward effects.

The slowdown in consumer demand was announced by weak retail sales in December and correlates with the temporary deterioration in the sentiment of private households. This was mainly attributable to the administrative standstill and the associated uncertainty. However, the shutdown did not play a special role for the result of the fourth quarter of 2018, as it did not come into force until the end of December. The foreign trade data for the fourth quarter were less conspicuous: both exports and imports increased slightly. Changes in inventories also made only a minor contribution to growth, having risen sharply in the third quarter of 2018. This entails certain downside risks for the first quarter of 2019.

4. Germany: corporate sentiment declines again

The ifo index, the indicator based on the most important business survey in Germany, fell again in February (to 98.5 points). This primarily affected the assessment of the current situation, but expectations also deteriorated somewhat again. The ifo Business Cycle Clock, which indicates "upswing", "boom", "downswing" or "recession" depending on the constellation of the business situation and expectations, is in the "downswing" zone for the second time in succession. The problems are concentrated in industry, while the services sector remains relatively stable. Against this backdrop, GDP stagnated in the fourth quarter of 2018 compared with the previous quarter. The weakness was caused almost exclusively by the export-oriented industry and was exacerbated by the problems in the automotive sector. Domestic demand, on the other hand, proved robust and contributed around +0.6 percentage points to GDP growth compared with the previous quarter. The moderate increase in private consumption was accompanied by a strong stimulus from public consumption and fixed capital formation. Inventories, which had arisen in the previous quarter as a result of the delay in passenger car emission tests, were partially reduced in the fourth quarter. Net exports were stable, while exports and imports increased to a similarly small extent. The export losses of the previous quarter were only offset.

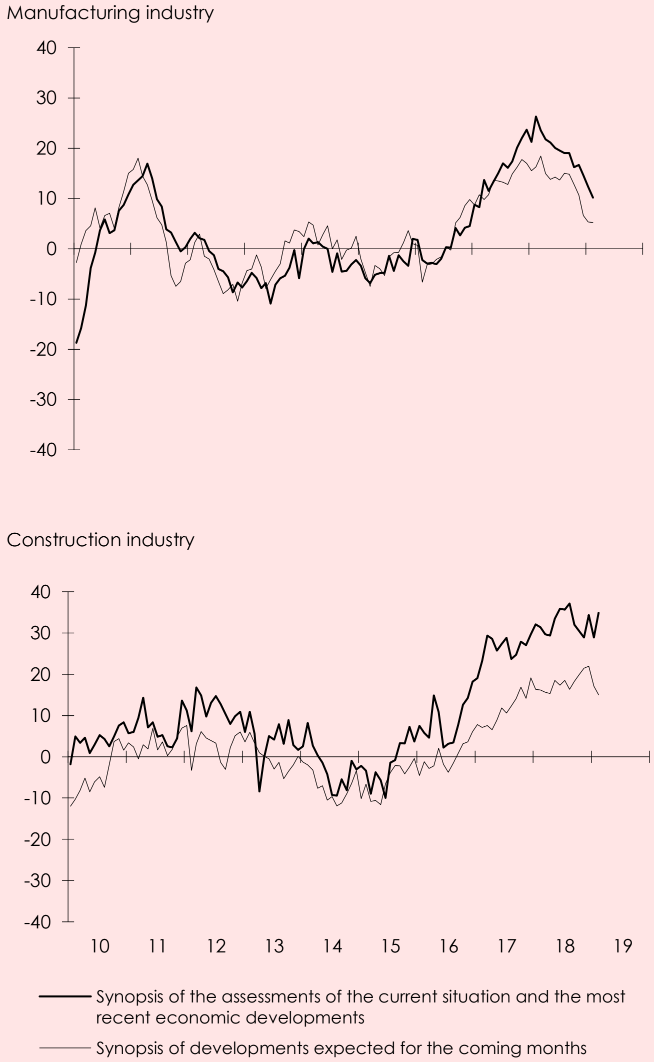
The pronounced change in inventories in Germany impacted on the euro zone average in the second half of 2018: the reduction in inventories dampened growth in the euro zone in the fourth quarter of 2018, while private and public consumption, gross fixed capital formation and net exports made positive contributions. GDP in the euro zone grew by 0.2 percent compared with the previous quarter.

5. No further deterioration in the sentiment in Austrian industry for the time being

According to the current WIFO-Konjunkturtest (business cycle survey), the assessment of economic development by Austrian industrial companies did not cloud over any further; the optimistic and pessimistic assessments of future development roughly balanced each other out in February. On the other hand, the companies assessed their current situation somewhat worse than in the previous month, but overall the positive feedback still outweighed the positive feedback quite clearly. In the service sectors, where the overall sentiment is more optimistic than in industry, the business climate index declined somewhat in February.

Figure 2: Results from the WIFO-Konjunkturtest

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

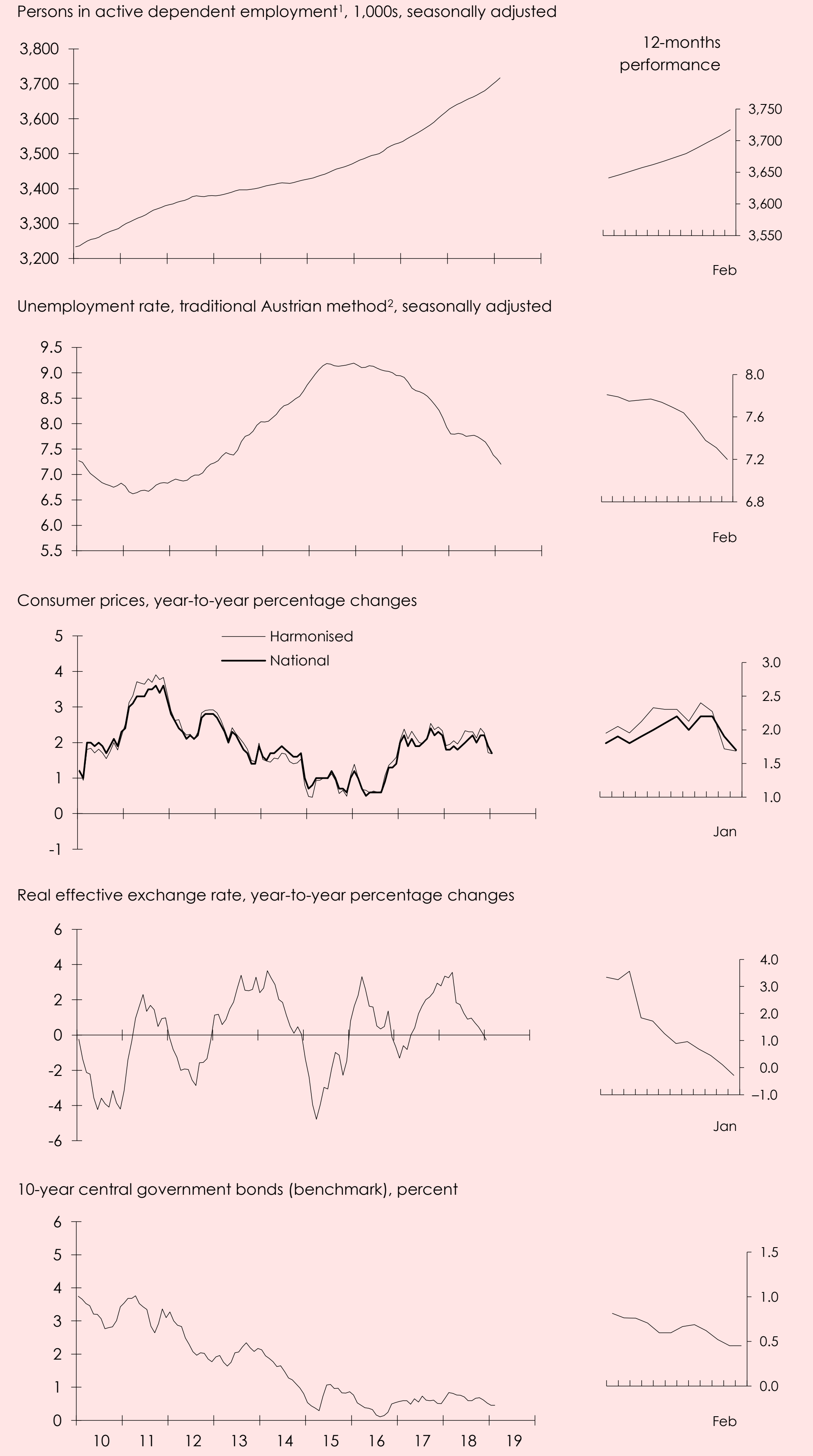


Source: WIFO-Konjunkturtest. Data refer to index points (percentage points) between +100 and –100. Values above 0 imply positive expectations, values below 0 indicate negative expectations.

According to the current quarterly national accounts of WIFO, the Austrian economy grew by 0.4 percent in the fourth quarter of 2018 compared to the previous quarter (trend cycle component). This confirms the result of the flash estimates made at the end of January. Growth in Austria continues to be broad-based, even though the second half of 2018 saw a slowdown for almost all demand components. Private consumption expenditure (including non-profit institutions serving households) expanded by 0.4 percent in the fourth quarter, general government expenditure by 0.1 percent, so that overall consumption increased by 0.3 percent. Gross fixed capital formation (investment in machinery and equipment, construction and other investment) also lost momentum in the second half of the year. Investments in machinery and equipment almost stagnated in the fourth quarter, with the decline in demand for vehicles in particular dampening the result (–2.0 percent). Foreign trade developed robustly towards the end of the year, with exports of goods increasing 0.5 percent, compared with the previous quarter. Exports rose by 0.7 percent overall due to the stronger dynamism of service exports.

The GDP growth of 0.4 percent calculated by the WIFO in its flash estimates for the fourth quarter of 2018 was confirmed by the current quarterly accounts.

Figure 3: Key economic indicators



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.

5.1 Heavy snowfall in January adversely affects winter tourism

Considerable snowfall in the Northern Alps dampened the growth in tourism demand in January, which had been very strong in the pre-winter season.

The first half of the winter season (November 2018 to January 2019) was favourable for the Austrian tourism industry: the number of guest arrivals was 3.1 percent higher and the number of overnight stays 2.9 percent higher than in the previous year. Austrian accommodation establishments recorded 31.74 million overnight stays in these three months. Around three quarters of this total was accounted for by foreign guests, whose demand developed much more dynamically (+3.8 percent year-on-year) than domestic demand (+0.4 percent).

After the number of overnight stays rose sharply in November and December 2018 (+7.9 percent and +8.0 percent, respectively compared to the previous year), demand declined in January (–2.1 percent). This development was probably caused by the abundant snowfall in some regions and the resulting measures (closure of pistes and road connections as well as entire ski areas, avalanche warnings), which were often perceived as a danger situation. The losses, which were particularly severe in the Länder with winter sports regions, are probably primarily attributable to the absence of day-visitors, while some of the overnight guests had to stay longer than planned.

5.2 Hardly any pressure on fuel prices

Consumer prices rose by 1.7 percent in January. Prices rose strongly again in the two sectors that have been causing above-average inflation in Austria for several years: tourism (catering services +3.0 percent, recreation and cultural services +3.0 percent) and housing (actual rentals for housing +3.3 percent). In the transport sector, on the other hand, costs did not increase particularly strongly any more (operation of personal transport equipment +1.4 percent) after the price increase in this sector reached its peak in October due to the small oil price shock in the run-up to the Iran sanctions and increased the price of operation of personal transport equipment by almost 8 percent. Together, the sectors "housing, water, energy", "catering services" and "recreation and culture" contributed more than half (+1.0 percentage points) to the overall inflation rate in January.

5.3 Rapid decline in unemployment in February

Unemployment among persons with health impairments increased again slightly.

After the decline in the number of unemployed had slowed to –11,200 in January compared with the previous year, it accelerated to –21,300 in February and was thus roughly as dynamic as the average for the second half of 2018. According to initial estimates, the unemployment rate in February amounted to 7.2 percent seasonally adjusted and 8.4 percent unadjusted. Around 49,000 of the 343,400 registered unemployed found no job due to seasonal reasons. Unemployment among the over-50s fell slightly year-on-year after rising for the first time in more than a year in January 2019. Unemployment among persons with health impairments, on the other hand, again rose slightly in February. In addition, the decline in the number of long-term unemployed persons slowed from an average of –15,200 in the second half of 2018 to –10,900 in February. The total number of long-term unemployed persons in February amounted to around 142,300.

According to preliminary figures, the employment expansion continued almost undiminished in February. Compared with the previous month, the number of persons in active dependent employment rose by 5,500 seasonally adjusted and by 72,000 (+2.0 percent) compared with the previous year. The number of job vacancies also increased again, and the number of unemployed persons per job vacancy fell to 3.8, seasonally adjusted.