

# Domestic Economy on the Decline – Corporate Expectations Improve

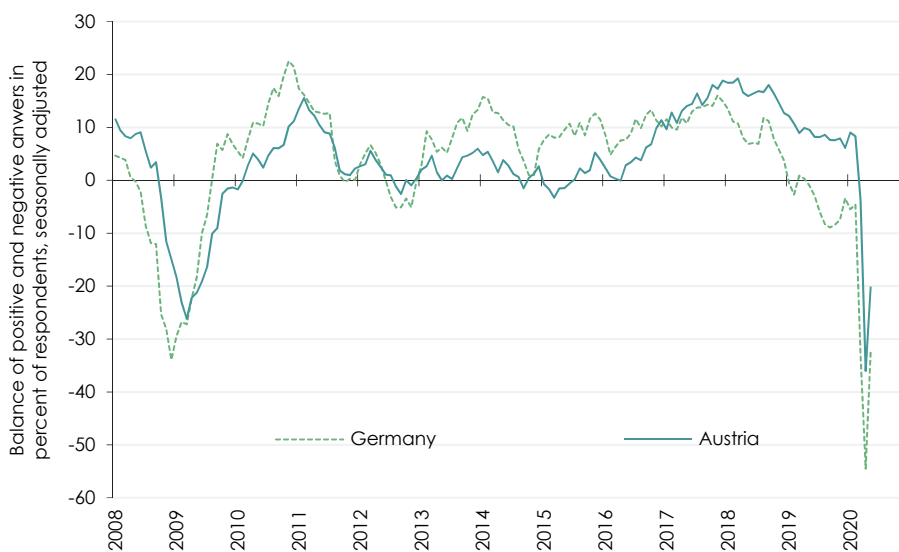
## Business Cycle Report of June 2020

Christian Glocker

- In Austria, supply restrictions and the collapse in demand in connection with the COVID-19 pandemic led to a massive reduction in economic output.
- The leading indicators from the WIFO-Konjunkturtest (business cycle survey) once again show a predominantly negative assessment of the current situation.
- After the historic slump in April, the index of corporate expectations rose in May.

### Business expectations in Germany and Austria

Overall expectations for coming months, total economy



**"In Austria, supply restrictions and the sharp drop in demand in the wake of the COVID-19 pandemic led to a massive reduction in economic output. Business expectations have recently improved."**

Business expectations rose in May in Austria and Germany after a historic slump in April, thus providing first indications of a possible rapid recovery of the economy (Source: ifo Business Survey, WIFO-Konjunkturtest, WDS – WIFO data system, Macrobond).

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### Domestic Economy on the Decline – Corporate Expectations Improve. Business Cycle Report of June 2020

Austria's economic output fell sharply and on a broad basis in the first quarter of 2020 due to the measures taken to contain the COVID-19 pandemic. Although companies continue to assess the current situation unfavourably, expectation indicators improved.

**JEL-Codes:** E32, E66 • **Keywords:** Business Cycle, Economic Outlook, Forecast

All staff members of the Austrian Institute of Economic Research contribute to the Business Cycle Report. For definitions used see "Methodological Notes and Short Glossary", <https://www.wifo.ac.at/wwwdocs/form/WIFO-BusinessCycleInformation-Glossary.pdf>

**Data processing:** Astrid Czaloun ([astrid.czaloun@wifo.ac.at](mailto:astrid.czaloun@wifo.ac.at)), Christine Kaufmann ([christine.kaufmann@wifo.ac.at](mailto:christine.kaufmann@wifo.ac.at)), Maria Riegler ([maria.riegler@wifo.ac.at](mailto:maria.riegler@wifo.ac.at)), Martha Steiner ([martha.steiner@wifo.ac.at](mailto:martha.steiner@wifo.ac.at)) • **Cut-off date:** 5 June 2020

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**Contact:** Christian Glocker, MSc ([christian.glocker@wifo.ac.at](mailto:christian.glocker@wifo.ac.at))

## 1. Introduction

The outbreak of the COVID-19 pandemic had a profound impact on the global economy and trade. After global economic growth had already lost momentum since the end of 2019, the downturn was significantly intensified as a result of the measures taken to contain the pandemic. In the first quarter, GDP of the USA contracted by 1.3 percent compared to the previous quarter, and that of the EU member countries by 3.3 percent.

In Austria, as well, the supply restrictions and the plummeting demand led to a massive reduction in economic output (seasonally and working-day adjusted according to Eurostat: first quarter 2020 –2.6 percent compared to the previous quarter). The measures taken at both domestic and international level to contain the pandemic affected economic activity in Austria on a broad basis. A large part of the consumer-related service branches was hit, some of which had to discontinue or largely restrict their business activities. Exports also fell sharply. Industrial production was 12.5 percent below the previous year's level. In addition to the drop in demand, border closures in particular hampered the supply of primary and intermediate products.

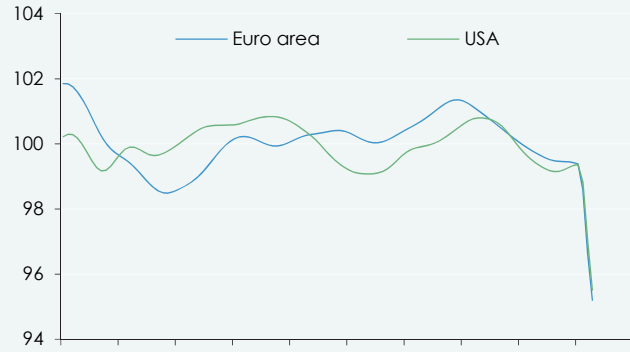
The leading indicators from the WIFO-Konjunkturtest (business cycle survey) once again show a predominantly negative assessment of the current situation. Business expectations, however, have recently improved – the corresponding index increased in May after the historic slump in April.

The impact of the pandemic countermeasures is seriously affecting the labour market. Although the situation on the labour market eased somewhat in May following a massive rise in unemployment, the overall situation remains precarious. The unemployment rate is still close to its previous highs. According to preliminary estimates, the number of persons in active employment in May was 162,000 lower than in the previous year (–4.4 percent). By comparison, in April the number of persons in active employment was 185,900 lower than in the previous year. The number of unemployed registered with the Public Employment Service Austria (AMS) was 194,350 higher in May than in the previous year (+69.7 percent), including persons in training by 174,100 (+50.7 percent). According to the national definition and preliminary estimates, the unemployment rate was thus up 4.7 percentage points on the previous year in May to an expected 11.5 percent.

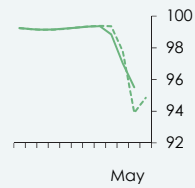
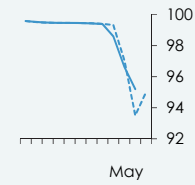
Figure 1: **International Business Climate**

Seasonally adjusted, 2015 = 100, 3-month moving average

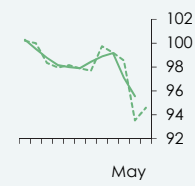
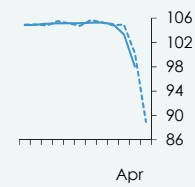
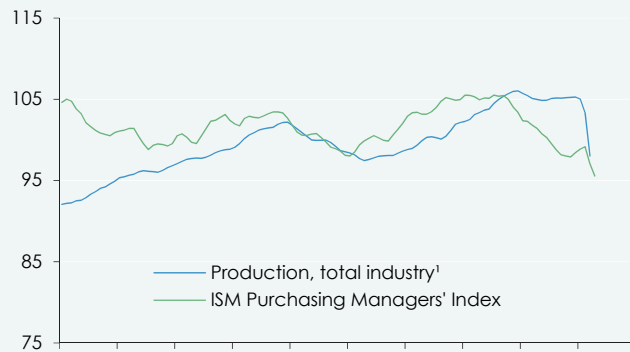
Leading indicators – amplitude



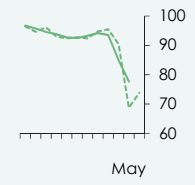
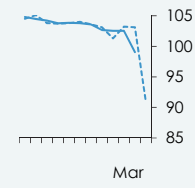
12-month performance



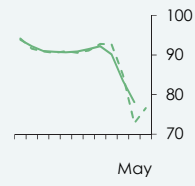
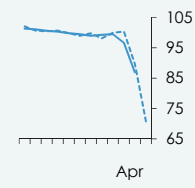
USA



Euro area



Germany



Source: European Commission, Deutsche Bundesbank, ISM (Institute for Supply Management™), ifo (Institute for Economic Research, Munich), OECD. – <sup>1</sup> Excluding construction. – <sup>2</sup> Manufacturing.

The global economy already lost momentum at the end of 2019. The downturn has now worsened significantly as a result of the measures to contain the COVID-19 pandemic.

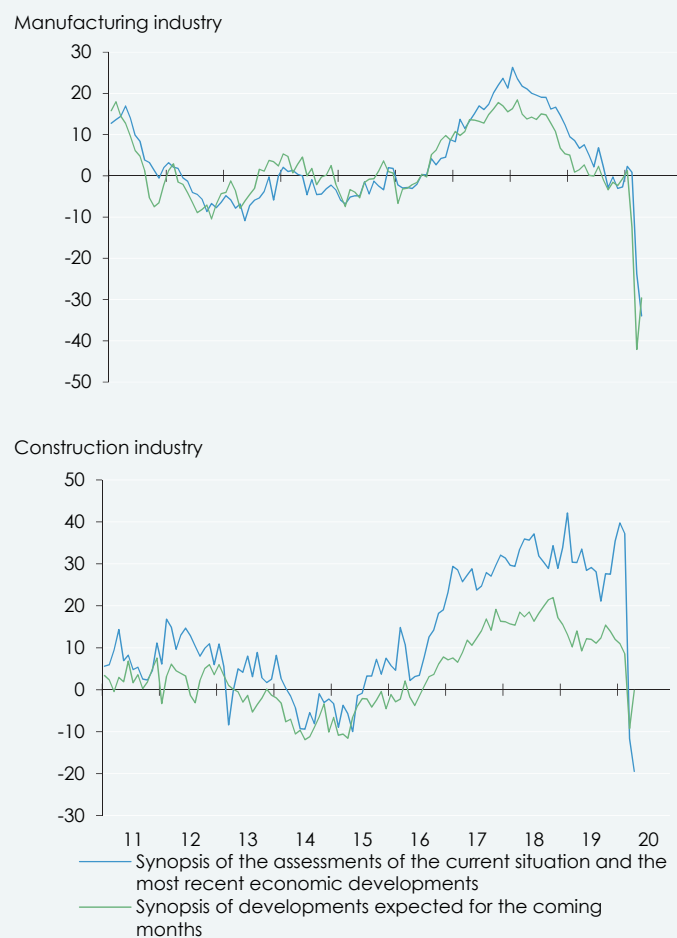
## 2. Slump in the global economy

In particular, the health policy restrictions imposed worldwide following the outbreak of the COVID-19 pandemic paralysed the global economy and trade. Within a few weeks, the global economy fell into a deep recession. In the emerging markets in particular, the economy was additionally burdened by the sharp drop in commodity prices, a significant tightening of financial conditions and considerable capital outflows. Politicians responded to the rapid deterioration in activity with vigorous measures. Central banks immediately used their leeway for interest rate cuts and lowered key interest rates and in some cases resumed asset purchases. In addition, extensive economic stimulus packages were adopted, the composition of which is primarily geared towards credit guarantees and income support measures.

Since the end of April, the restrictions in Europe, but also in the USA, have been gradually eased, allowing companies to resume operations in some areas. The path of recovery will depend largely on the speed of these easing measures. Surveys show that the containment measures affected the economy abruptly and profoundly. IHS Markit's global Purchasing Managers' Index (PMI) for the economy as a whole slumped from over 50 in January 2020 to under 30 in April. Country-specific data for May are already providing initial indications of a recovery. However, the improvement in sentiment indicators is primarily limited to business expectations – indicators for assessing the current situation continue to paint a clearly negative picture.

Figure 2: **Results from the WIFO-Konjunkturtest (business cycle survey)**

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.

Two important topics from the time before the outbreak of the COVID-19 crisis are gaining importance and attention again. The first concerns trade relations – and now probably also general relations – between the USA and China, which have been strained by a sharpened rhetoric in recent weeks. This is due not only to the US distrust of China's compliance with the first phase of the January 2020 trade agreement, but also to the suspicion that China deliberately did not pass on information about the COVID-19 pandemic and did not participate in the investigation of its causes. The second issue is the continued failure to reach any agreement on the UK-EU Brexit Agreement. On the other hand, a new economic policy issue concerns the European Central Bank (ECB): its measures have recently come under increased criticism. While concerns about the risks of the ECB's extremely loose monetary policy, which it has been for decades, have continued to grow, doubts about the constitutionality of the ECB's asset purchase programme have further intensified.

### 2.1 Consumer reticence weighs on US economy in the first quarter

The measures to contain the COVID-19 pandemic resulted in a decline in US economic output in the first half of 2020, particularly in the second quarter. GDP contracted by 1.3 percent quarter-on-quarter in the first quarter – the largest decline since the global financial market and economic crisis (fourth quarter of 2008 –2.2 percent). Even greater negative effects are expected for the second quarter. By the end of March, almost all federal states had ordered extensive company closures and strict movement restrictions. As a consequence, unemployment rose considerably. Consumer confidence and thus private household consumption collapsed subsequently.

Politicians introduced extensive support measures for the economy. Congress approved fiscal support of almost 10 percent of GDP, consisting of government spending to contain the COVID-19 outbreak and measures to mitigate its effects. At the same time, the Federal Reserve System lowered the target range for the federal funds rate to 0 percent to 0.25 percent. In addition, it established a number of credit facilities that can provide up to 2.3 trillion \$ in funding, activated swap lines with other central banks, expanded its repo operations and relaxed its oversight policy to ensure that financial markets remain liquid and credit flows continue smoothly.

By April, a number of survey-based indicators had declined. However, the latest data

(May) already point to an improvement in the business climate. The optimism reflected in this data is likely to be exaggerated in light of the recent social unrest in the USA. The measures to curb violence in the form of curfews etc. are too recent to be reflected in the May business surveys. The duration and scope of the measures to restore social stability now add to the uncertainty surrounding the recovery of the economy.

### 2.2 Economic output collapses in the euro area between January and March

The latest GDP data confirm that the COVID-19 pandemic will have a devastating impact on the euro area economy. GDP contracted by 3.8 percent compared to the previous quarter. Economic activity was mainly affected by government measures to contain the spread of the disease. The most severe restrictions were imposed in Italy, Spain and France, while measures were less restrictive in Germany, for example. In Spain (–5.2 percent), France and Italy (both –5.3 percent), GDP contracted considerably compared to the previous quarter, while in Germany it fell by only 2.2 percent. The decline was concentrated in the services sector. Especially in tourism, substantial and prolonged losses are expected.

However, leading indicators suggest an even greater decline in the second quarter. The restriction of economic activities lasted much longer in the second quarter of 2020 than in the first quarter (only 2 to 4 weeks). In most countries the restrictions in their strictest form were applied until the end of April, and their easing has already been initiated, but is taking place gradually. The recovery is further slowed by consumer concerns (precautionary savings), delays in supply chains and the fact that the timing of the lifting of restrictions varies from country to country. On the other hand, the impact of fiscal policy incentives to address the economic impact of the pandemic is likely to be felt gradually.

The first signs of stabilisation can be observed in the euro area. IHS Markit's Composite Purchasing Managers' Index (PMI) for the euro area rose from an all-time low of 13.6 in April to 31.9 in May, its highest level since February. Although it remained well below the threshold of 50.0, the extent of the rise was considerable. The lowest level so far was reached at the height of the global financial market and economic crisis in February 2009. The European Commission's Economic Sentiment Indicator (ESI) provides similar results. Although the current situation is still assessed as almost as unfavourable as in previous months, expectations have improved significantly.

**GDP in the euro area fell by 3.8 percent in the first quarter compared with the previous period. Among the large countries the decline was particularly high in France, Spain and Italy.**

**Consumption, the main driving force of the US economy, came under massive pressure due to health policy restrictions and consumer reticence on part of private households. The considerable deterioration in consumer sentiment is dampening the outlook.**

### 3. Austria: significant decline in economic output in the first quarter of 2020

The supply restrictions and the drop in demand led to a massive reduction in economic output in Austria.

In January and February, real economic activity in Austria still expanded on a broad basis, but in March it collapsed due to the COVID-19 pandemic. In the first quarter of 2020, economic output fell by 2.9 percent year-on-year and by 2.6 percent quarter-on-quarter (seasonally and working-day adjusted according to Eurostat). The steep slump is particularly reflected in the quarter on quarter comparison of seasonally adjusted figures. As the measures to contain the pandemic largely persisted in April and the easing is only gradual, the decline in GDP in the second quarter is likely to be much higher than in the first quarter.

The consumer-related trade and service sectors are particularly affected. Although the retail trade recorded increased business activity in the basic services sector (e.g. food trading), this did not compensate for the losses in other sectors (e.g. clothing, shoes). In tourism, the premature end of the winter season and the closure of operations led to a loss of sales. Overall, value added in the retail, maintenance and repair of motor vehicles, transport, accommodation and catering sectors fell by 7.3 percent year-on-year. This slump was responsible for more than half of the GDP decline in the first quarter.

In the areas of sports, cultural and entertainment facilities and personal services (e.g. hairdressers), value added fell by 8.1 percent. On the other hand, the development of the information and communication, credit and insurance, real estate and public administration sectors had a stabilising effect.

After the industry had already fallen into recession in the course of 2019, the production losses in March further intensified this development. In the first quarter, the value added in the production of tangible goods fell by 6.6 percent compared with the same quarter of the previous year. The working day adjusted production index for the manufacturing sector (NACE B to E) fell by 12.5 percent in March 2020 compared to March 2019. Compared with February 2020, the seasonally adjusted index of production fell by 7.8 percent. The recent development of producer prices also fits into this picture: In February and March 2020, the producer price index for the manufacturing sector fell by 1.5 and 0.7 percent respectively compared with the same month of the previous year. The downward trend continued in April as the crisis persisted. In April 2020 the price index fell by 2.4 percent year-on-year.

On the demand side, consumption, which has a stabilising role over the economic cycle, was massively restricted by the health policy measures and the reluctance of private households to spend; private consumption expenditure fell sharply in the first quarter. In contrast, public consumption expenditure increased strongly. Given the increased uncertainty, investment activity was also severely restricted. In line with the loss of domestic demand, imports also declined. Last but not least, against the backdrop of the global impact of the COVID-19 pandemic, exports also fell sharply in the first quarter.

#### 3.1 Leading indicators give first positive signals

Although the WIFO Economic Climate Index (seasonally adjusted) rose, the mood among Austrian companies remains at crisis level after the historic slump in April 2020.

The index of current assessments of the overall economy continued to decline in May (seasonally adjusted), reaching the lowest level ever measured. The decline is evident in all sectors. In the services sectors, the index fell by 5.1 points to its lowest level since the beginning of the evaluations. In the construction industry it lost 7.8 points, but at -19.5 points it remained above its previous low. In the manufacturing sector, the situation index lost 10.2 points, and at -34.0 points was close to its previous low.

In the meantime, however, the expectations of companies in all sectors improved. After the historic slump of the previous month, the index of corporate expectations rose in May.

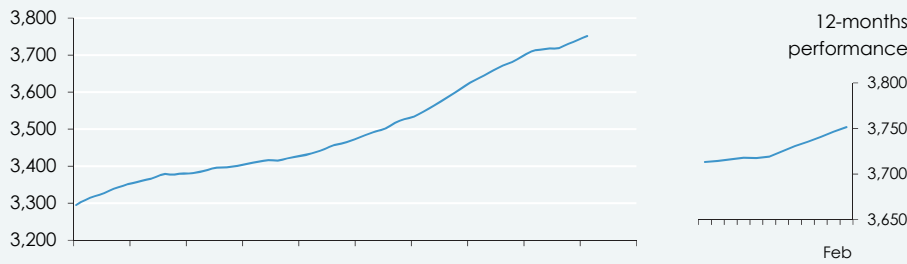
The expectations index rose most strongly in the services sectors, but here too it remained clearly in negative territory. The index of expectations also recovered significantly in the manufacturing sector, but overall it remained at a level similar to that last seen in the financial market and economic crisis of 2008-09. The expectations index also recovered in the construction industry and is now close to the long-term average.

The UniCredit Bank Austria EinkaufsManager-Index paints a similar picture: after its low in April, it has now improved. Despite the strongest monthly increase to date, it was still below the 50 point mark, which signals growth in the industry. The index for new business and production output rose sharply.

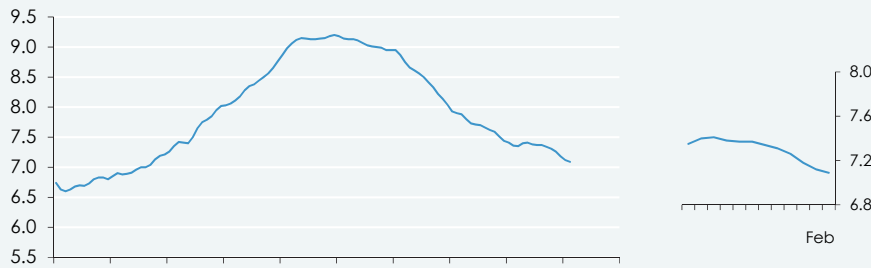
While business surveys continue to point to a pessimistic assessment of the current situation, expectation indicators have now improved.

Figure 3: **Key economic indicators**

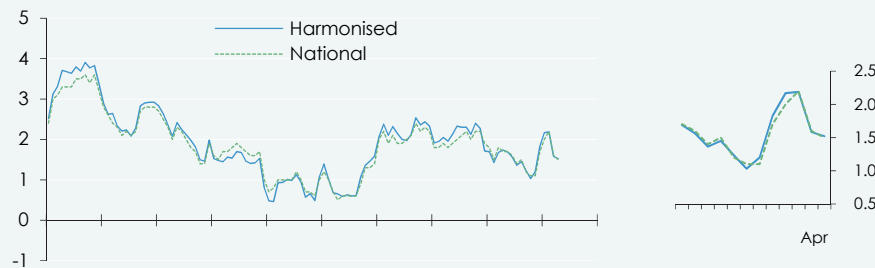
Persons in active dependent employment<sup>1</sup>, 1,000s, seasonally adjusted<sup>2</sup>



Unemployment rate, traditional Austrian method<sup>3</sup>, seasonally adjusted<sup>2</sup>



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 Social Security Institutions, Oesterreichische Nationalbank, Statistics Austria, WIFO calculations. – <sup>1</sup> Excluding persons in valid employment contract receiving child care benefit or being in military service. – <sup>2</sup> Due to the current marginal values in the course of the Corona crisis, the seasonal adjustment does not provide interpretable results and is therefore suspended until further notice. – <sup>3</sup> As a percentage of total labour force excluding self-employed, according to Public Employment Service.



### 3.2 Labour market severely affected by the consequences of the COVID-19 pandemic

Although the situation on the labour market eased somewhat in May, the overall situation remains precarious. The unemployment rate was still close to its previous highs.

The slump in economic activity is leaving deep marks on the labour market. According to preliminary estimates, the number of employed persons in May was 162,000 lower than in the previous year (−4.4 percent), compared with −185,900 in April. In addition, 1.37 million workers were on short-time work, more than a third of the workforce.

In May, 194,350 more people were registered as unemployed than in the previous year (+69.7 percent), including persons in training courses by 174,100 (+50.7 percent). According to the national definition, the unemployment rate was thus 11.5 percent in May (according to preliminary estimates) (+4.7 percentage points compared to the previous year).

### 3.3 Inflation subdued in April

The fall in fuel prices had another dampening effect on inflation in April.

At 1.5 percent, the inflation rate in April 2020 was 0.1 percentage point lower than in the previous month. Prices in the "housing, water, energy" sector rose by an average of 2.3 percent year-on-year, contributing +0.46 percentage points to the general inflation. They were thus the strongest price driver year-on-year. Maintenance of flats increased by 3.1 percent, while rents rose by 3.2 percent. Household energy prices were almost stable (+0.5 percent on average), as the increase in electricity prices (+7.0 percent) was offset by the massive drop in heating oil prices (−23.6 percent). Food and non-alcoholic beverages became more expensive on average by 2.6 percent. Prices in

the transport sector declined significantly, above all because fuel prices fell by a total of 14.7 percent.

The extensive restrictions on public life to contain the COVID-19 pandemic also affected the calculation of the inflation rate for the month of April: according to Statistics Austria, some of the prices could not be collected as usual and were therefore replaced or continued.

### 3.4 Considerable impairment of tourism

The number of overnight stays fell by 24.9 percent to 42.26 million between January and April 2020, whereby the decline in domestic demand (31.3 percent) was greater than that in foreign demand (−23.2 percent). During the same period, the number of arrivals remained 31.9 percent below the prior year level at 9.97 million. As expected, overnight tourism came to a virtual standstill in April 2020 due to border and factory closures, according to preliminary results. With around 287,000 overnight stays, 7.92 million overnight stays or 96.5 percent fewer than in April of the previous year were registered.

The 2019-20 winter season (November to April) ended 1½ months ahead of schedule due to official measures. At 59.72 million, the number of overnight stays for the entire season was 18.1 percent lower than in the previous year at 59.72 million and roughly in line with the 2006-07 winter season (59.38 million).