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# Economic Activity Remains Subdued

## Business Cycle Report of November 2011

**The global economic environment continues to weaken. Notably the euro crisis has been contributing to heightened uncertainty. This is having a noticeable effect on economic activity in Austria.**

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The pace of global economic growth continues to moderate. World trade broadly stagnated between March and August, according to Centraal Planbureau (CPB). This loss of momentum has been particularly apparent in recent months in Asia's emerging markets, whose economies had been the drivers of the recovery following the financial market and economic crisis. The euro area registered an even more marked loss of momentum, with imports of goods declining noticeably there. In the USA, by contrast, GDP rose at a surprisingly brisk quarter-on-quarter pace of 0.6 per cent in the third quarter. But here, too, the leading economic indicators – primarily consumer confidence – point to a dampening of economic activity. The ongoing tense labour market situation is weighing on expectations. Industry indicators are painting a more favourable picture: new orders and production have been rising recently.

Estimates for GDP growth in the third quarter are not yet available for the euro area; however, signs are emerging of a stagnation of economic output in the second half of the year. The persistent euro crisis and the deterioration of the global economic environment are noticeably dampening the expectations of businesses and private households. The situation in the labour market remains tense. In September, the seasonally adjusted unemployment rate rose to 10.2 percent. It was exceptionally high in the countries in crisis Spain, Greece, Ireland and Portugal as well as in the Baltic countries, Slovakia and Bulgaria.

In Austria, economic output expanded vigorously in the first half of 2011. However, in the second half of the year signs have been mounting also here of a marked moderation of economic activity. The weakening of the international environment is having an impact notably on the export-oriented manufacturing sector. Production was still expanded in August, and capacity utilisation and order book levels have also been high recently. However, firms' expectations regarding production and their business situation in the coming months have been declining for several months, with negative production expectations for the first time outweighing positive expectations in October, according to the WIFO Business Cycle Survey. An appreciable deterioration is also apparent in the construction and services sectors.

The economic slowdown is already being felt in the labour market. The number of persons in dependent active employment did increase somewhat in October, but the unemployment rate did not decline. It stood at 6.9 percent on a seasonally adjusted basis, according to the Austrian method of calculation. The number of persons enrolled in training programmes has been falling sharply, however.

Energy and commodity prices, after rising vigorously in spring, have been falling again lately. This has been holding back domestic price pressures. Annual inflation

as measured by the national CPI was 3.6 percent in September, however. HICP inflation stood at 4.0 percent.

The global economy continues to lose momentum. World trade again recovered somewhat in August, increasing by 1.3 percent in real terms month-on-month (July +1.0 percent), albeit after broadly stagnating since March. Industrial production also expanded slightly; it rose at a month-on-month rate of 0.3 percent in August (July +0.4 percent). In recent months the slowdown in world trade has affected notably Asia's emerging markets, whose economies had been the drivers of the economic recovery following the financial market and economic crisis. The euro area registered an even more marked loss of momentum; here the consequences of the persistent euro crisis could be seen directly. In both regions real imports of goods rose again significantly in August, however. In the USA, by contrast, they stagnated since the beginning of the year. Japan's economy suffered from the impacts of the earthquake, especially in spring; but the decline in real merchandise imports recorded in March and April has been more than offset since then.

The US economy expanded at a surprisingly brisk pace in the third quarter (+0.6 percent, quarter-on-quarter), after only modest growth in the first half of the year (first quarter +0.1 percent, second quarter +0.3 percent). Personal consumption expenditure and a strong expansion of business spending on machinery and equipment accounted for most of this growth. But labour market conditions once again failed to improve: while the seasonally adjusted unemployment rate, at 9.0 percent in October was down 0.7 percentage point relative to October 2010, it has been largely stagnant since April. In October, the number of persons employed rose by around 80,000 on a seasonally adjusted month-on-month basis, and by 1.5 million compared with a year before.

Given the persistent problems in the labour market, the still tense situation in the real estate market, and the high indebtedness of private households, expectations concerning future economic developments remain subdued. The ISM Purchasing Managers' Index fell again in October, reaching a level as low as in mid-2009. The Conference Board Consumer Confidence Index also declined further. The industry indicators, by contrast, provide a positive picture: industrial production picked up in September, new orders improved further in July.

Estimates for GDP growth in the third quarter are not yet available for the euro area. In August industrial production increased by 1.5 percent compared with the previous month (July +1.2 percent). The leading economic indicators point to a marked slowdown, however: production expectations and order books continued to decline in October, according to the EU business cycle survey, and industrial and consumer confidence also fell appreciably. The Ifo Business Climate Index for Germany also weakened, the business situation deteriorated but was still assessed as being favourable. The persistent uncertainty resulting from the euro crisis likely plays a decisive part in this development. The global economic environment is also providing a negative impetus: according to the CPB, euro area real exports in goods were largely flat between May and August. According to the economic indicator calculated by the Euroframe Network (Euro Growth Indicator)<sup>1</sup>, the euro area economy is likely to broadly stagnate in the second half of 2011 (third quarter -0.1 percent, quarter-on-quarter, fourth quarter +0.1 percent).

Labour market tensions continue to increase in the euro area. In September the seasonally adjusted unemployment rate rose to 10.2 percent. It was thus again in line with the peak recorded in mid-2010. The situation is particularly dramatic in the labour markets of the countries strongly affected by the crisis: in September, the seasonally adjusted unemployment rate reached 22.6 percent in Spain, and 12.5 percent in Portugal. In Greece it rose to 17.6 percent in July. Ireland has seen its rate fall again somewhat lately, albeit from high levels (September 14.2 percent). In the Baltic countries and in Slovakia and Bulgaria the unemployment rate also exceeded the euro area average.

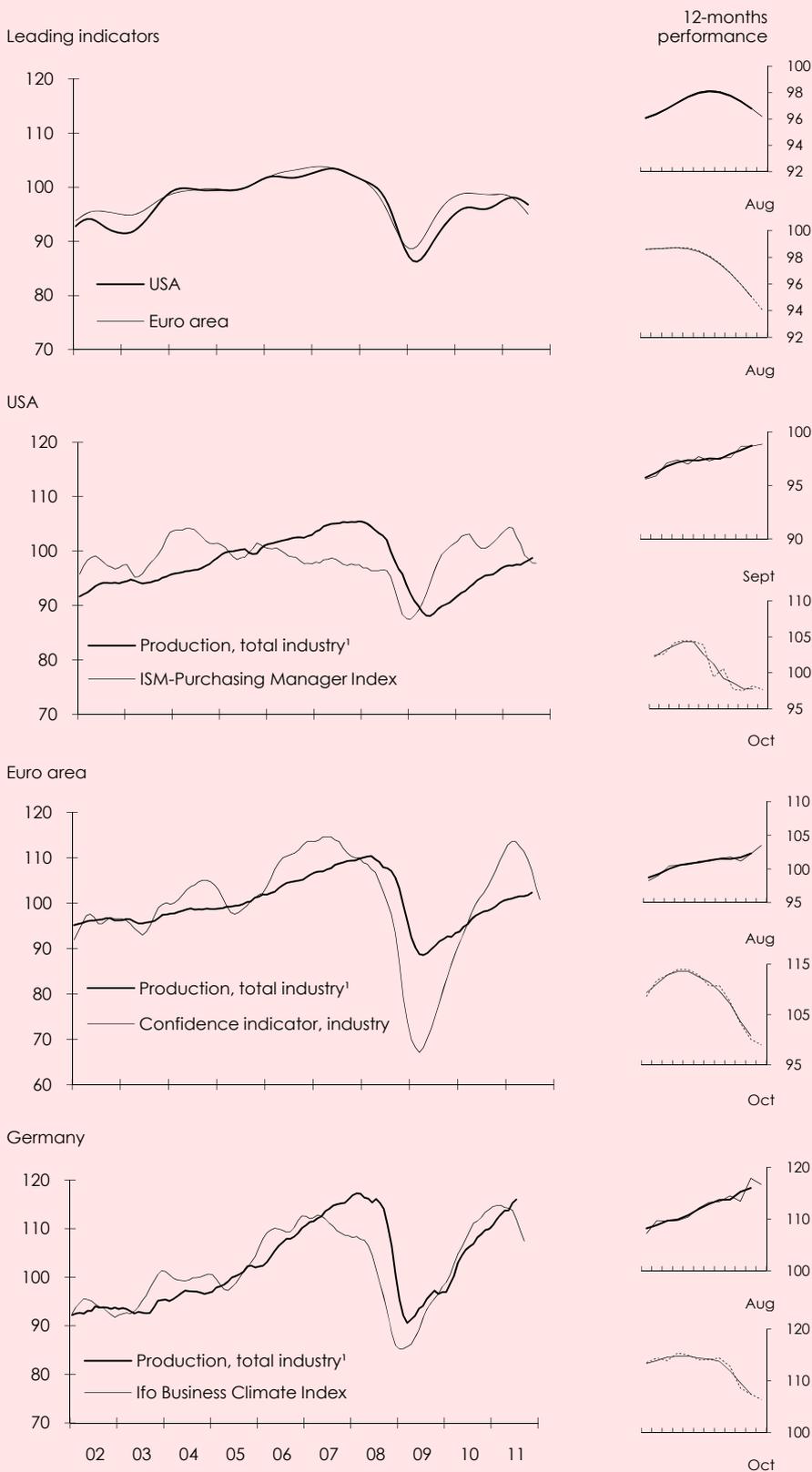
## Global economic activity weakening further

*Signs are increasing that the global economy is weakening. Notably the euro crisis is likely to heighten uncertainty significantly.*

<sup>1</sup> <http://www.euroframe.org/index.php?id=9>.

Figure 1: International business climate

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



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

Energy and commodity prices again fell markedly from their peaks in spring. The price of crude oil (Brent) slightly exceeded \$ 100 per barrel at the beginning of No-

vember, while in October the HWWI Index of World Market Prices of Commodities excluding energy was around 10 percent below the peak in April. This development is likely to reduce inflationary pressures. However, annual consumer price inflation remains high, accelerating to 3.9 percent in the USA and to 3.0 percent in the euro area in September. The core inflation rate stood at 2.0 percent in both economic regions in September. According to the first estimate for October, annual consumer price inflation was 3.0 percent in the euro area.

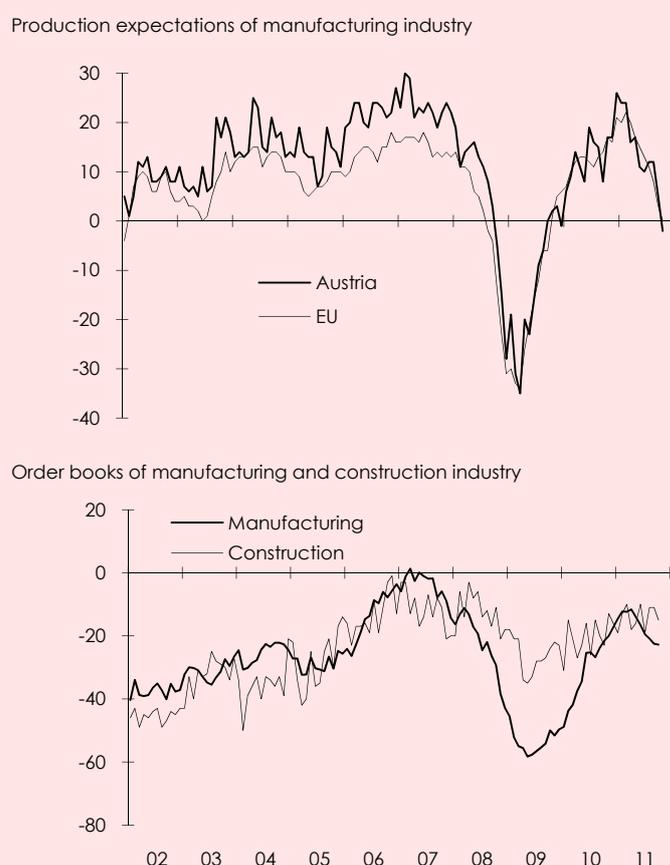
The Austrian economy expanded vigorously in the first half of 2011, in the second quarter real GDP grew by 0.7 percent on a seasonally and working day adjusted quarter-on-quarter basis (first quarter +0.8 percent). But the global economic slowdown has already left its mark, this time growth was almost exclusively driven by domestic demand. In the case of consumption this became possible only by a further decline in the saving rate, given the subdued income growth.

### Marked economic slowdown in second half of the year

*In Austria, too, indicator developments point to a slowdown in economic activity.*

Figure 2: 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.

In the second half of this year signs of a marked dampening of economic activity have been increasing also in Austria. Manufacturing output did increase slightly in August; but according to WIFO's October Business Cycle Survey, order book levels have been falling continuously since spring. Production expectations are also predominantly negative: for the first time in more than 1½ years more firms anticipated a decline in production than an expansion. The appraisal of the business situation in six months' time also turned out substantially more unfavourable than previously; here pessimistic expectations have been outweighing optimistic ones already since

July. Sentiment has darkened in all sectors, but the deterioration is particularly pronounced in the capital goods, consumer durables and motor vehicle sectors.

The assessment of order books deteriorated also in the construction industry. Construction activity remained significantly below its average level over the last five years. This suggests that the pace of activity will moderate also in the construction sector. The slowdown has been less pronounced in the services sector, but for the first time since 2009 more firms are anticipating a worsening of the business situation also here.

Tourism sales posted an increase of 3.6 percent on average over the months from May to September, compared with the same period a year before, to € 8.93 billion, according to provisional calculations. But the increase was exclusively price-related; in real terms, sales stagnated (+0.2 percent). The number of overnight stays increased by 2.2 percent over this period. Hence, real expenditure per night spent – a quality indicator – declined by 2.0 percent. The demand for overnight stays by travellers from abroad exceeded the year-earlier level by 2.7 percent, while that by domestic travellers rose by 2.1 percent.

As regards the foreign source countries of importance for Austria, an increase in overnight stays over this period was registered notably for guests from Russia (+30.2 percent), Poland (+21.6 percent), Hungary (+15.7 percent), the Czech Republic (+13.2 percent), and Switzerland (+9.3 percent). Overnight stays by travellers from Romania (+4.1 percent) and Germany (+2.4 percent) also developed favourably, whereas the demand from Belgium (–0.1 percent) and France (–0.8 percent) was broadly flat. A decline was recorded in the number of overnight stays by travellers from the Netherlands (–1.5 percent) and from Italy (–2.7 percent) as well as from Sweden (–6.2 percent), the UK (–8.8 percent), Denmark (–9.1 percent) and the USA (–10.6 percent).

Lower Austria posted the strongest gains in tourism sales; an above-average increase was also registered in Vienna, Upper Austria, Carinthia, Salzburg, Styria and Vorarlberg. Sales growth was below average in Burgenland and Tyrol.

The situation in the Austrian labour market has darkened. According to preliminary calculations for October, the number of persons in dependent active employment increased by 66,000 (+2.0 percent) year-on-year, but the seasonally adjusted month-on-month rate was +0.2 percent, unchanged from September. The number of unemployed increased further, however. In October, the seasonally adjusted number of persons registered as unemployed rose by 2,400 (+1.0 percent) from the previous month. Compared with a year before, the number increased by 8,900 persons (+3.9 percent). The number of job vacancies was down by 6.1 percent compared with a year before. However, on a seasonally adjusted month-on-month basis it rose by 0.8 percent in October. The number of persons enrolled in training programmes fell markedly (–9.0 percent, year-on-year). At 6.9 percent, the seasonally adjusted unemployment rate according to the Austrian definition was in line with the rate recorded in September.

Annual consumer price inflation as measured by the national CPI was 3.6 percent in September. The strongest price increases were registered in the education (+6.0 percent), transport (+6.0 percent), restaurants and hotels (+4.5 percent), food and non-alcoholic beverages (+4.5 percent) as well as alcoholic beverages and tobacco (+4.0 percent) categories.

The harmonised inflation rate (HICP), at 4.0 percent exceeded the euro area average by 1 percentage point. Core inflation (HICP excluding energy and unprocessed food) stood at +3.3 percent in September (euro area +2.0 percent). The largest contributors to the inflation differential were the restaurants and hotels, recreation and culture as well as food and non-alcoholic beverages categories.

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## Tourism stagnating

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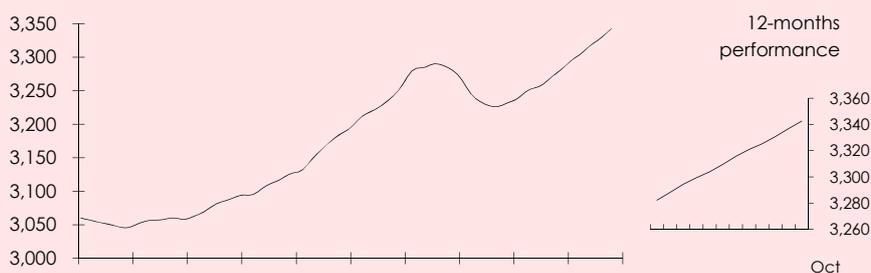
## Labour market remains tense

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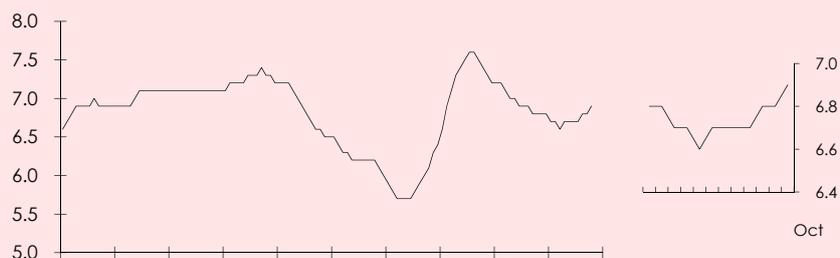
## Inflation rate rising markedly

Figure 3: Key economic indicators

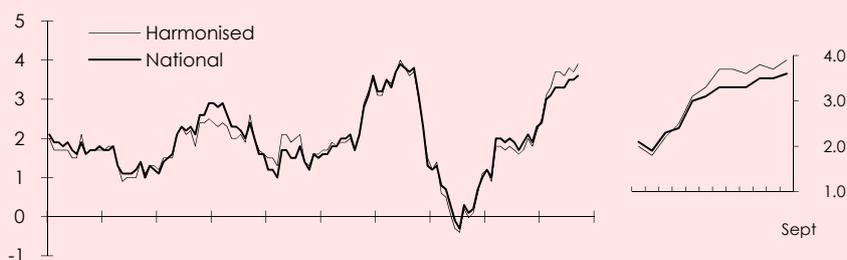
Persons in active dependent employment<sup>1</sup>, (1,000), seasonally adjusted



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



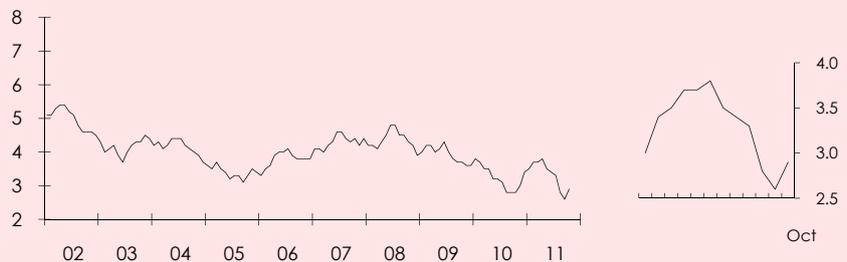
Consumer prices, year-to-year percentage changes



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. – <sup>1</sup> Excluding parental leave, military service, and unemployed persons in training. – <sup>2</sup> 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".