

Marcus Scheiblecker

# Austria's Economy Grows Markedly Faster than the Euro Area Average

## Business Cycle Report of August 2016

### Austria's Economy Grows Markedly Faster than the Euro Area Average. Business Cycle Report of August 2016

Economic activity in Austria is gaining further momentum. According to WIFO's latest Business Cycle Survey, business sentiment in some sectors in Austria is at an all-time high. Both manufacturing and construction as well as services companies currently report very buoyant business activity and are optimistic regarding their business outlook. In the second quarter, Austria was among the euro countries with the highest economic growth. Hence, labour market developments remained favourable. The global economy is also strengthening.

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Austria's GDP increased briskly again in the second quarter of 2017. As already in the first quarter, the trend-cycle component calculated in WIFO's Flash Estimate rose by 0.8 percent in real terms, quarter-on-quarter. Calculated according to the Eurostat method, which adjusts data only for seasonal and calendar effects, the increase in the second quarter was even 0.9 percent, after +0.7 percent. Hence Austria was among the euro countries experiencing the sharpest economic growth. The expansion was driven by lively export demand and gross fixed capital formation, whereas consumer spending declined somewhat.

The marked pick-up in economic activity is also reflected in business surveys. In July, the present situation index for the economy as a whole rose to its highest level in ten years. Expectations regarding future economic developments even reached record highs. In manufacturing, the present situation index rose by 2.5 points, reaching a level last recorded in spring 2011. In the construction sector, this index also rose again vigorously from an already high level. The services sector registered a slight decline, while expectations are still extremely optimistic.

The upswing is broad-based not only across economic sectors, but also across countries. The German ifo Business Climate Index, for instance, has been progressively climbing to new peaks since May. Businesses have been assessing notably the current economic situation as positively as never before. France and Italy are also experiencing a marked improvement in economic conditions. Economic growth in the EU countries and the euro area averaged 0.6 percent in the second quarter, after +0.5 percent in the first quarter.

After a pause, growth accelerated again also in the USA in the second quarter. According to a first estimate, GDP also increased by 0.6 percent, after a mere +0.3 percent in the previous quarter.

The development in emerging market economies, until recently lagging behind global economic activity, now appears to be catching up again. In China, growth increased from 1.3 to 1.7 percent, quarter-on-quarter, in the second quarter. For Brazil, the OECD's leading indicators signal a strong acceleration in the coming quarters, while in Russia the economic situation is also improving.

In this favourable environment for the Austrian economy, the demand for labour is growing vigorously. In July, the number of persons in active dependent employment rose significantly compared with a year before (+2 percent) in Austria, according to estimates by the Federal Ministry of Labour, Social Affairs and Consumer Protection (BMAK). It was possible to reduce unemployment further, and the unemployment rate for July according to the Austrian method of calculation was estimated at 7.6 percent,  $\frac{1}{2}$  percentage point below the year-earlier level. On the one hand, this reduces the burden on the government budget, while, on the other hand, robust domestic demand fuelled a sharp increase in tax revenues in the first half of the year.

## 1. International economic upswing taking hold across emerging market economies

In Japan, economic growth in the first quarter of 2017, at +0.3 percent in real terms was similarly subdued as in the USA, while in the EU GDP expanded at a considerably faster pace (+0.5 percent). In the second quarter, growth in the USA accelerated again to +0.6 percent. Both private consumption expenditure and investment activity picked up again. There are no signs that the upswing that has been lasting for already nine years now may come to an end as the year progresses. While at the beginning of 2017 the results of business and private household surveys did fall slightly from their peaks, they recovered again in June and July. Hence the upswing should remain intact in the third quarter, at least.

In the USA, the Federal Reserve is still hesitant to take back its extremely expansionary monetary policy pursued since the last recession. The present economic situation and the associated labour market conditions would justify a tightening, but consumer price inflation has not accelerated so far. Rather, from 2.7 percent in February 2017, inflation receded gradually over the subsequent months to just 1.6 percent in June. The unemployment rate has been trending down since the beginning of the year, and in July, as in May, came in at 4.3 percent, which was below the trough reached before the 2008-09 recession.

The monetary policy tightening in the USA is taking place more slowly than markets expected; these corrections of expectations weigh increasingly on the external value of the dollar. Since the beginning of the year, the dollar has lost more than 10 percent of its value against the euro.

With trend growth declining, China's economy has expanded less strongly year after year. While this trend is likely to continue, cyclical swings may briefly interrupt this development. At the beginning of the year, GDP increased by a mere 1.3 percent, quarter-on-quarter (fourth quarter of 2016 +1.7 percent). Growth picked up again in the second quarter on the back of higher exports and investment, and the economy expanded once again by 1.7 percent. Business surveys and the upswing of the global economy suggest that economic activity in China will strengthen this year.

Brazil appears to have overcome the recession. Having declined for eight quarters in a row, GDP rose sharply in the first quarter of 2017 (+1 percent in real terms, compared with the previous quarter). The Russian economy also appears to be climbing out of recession; after seven quarters of contraction, GDP rose again slightly on a year-on-year basis in the fourth quarter of 2016 and the first quarter of 2017.

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. – <sup>1</sup> Excluding construction.

### 1.1 Europe remains growth pole but shows little acceleration

Eurostat's flash estimate for economic growth substantiates the currently favourable economic development in the EU and the EU area. In the second quarter, both economic regions registered real GDP growth of 0.6 percent quarter-on-quarter, af-

ter +0.5 percent in the first quarter. Thus economic activity accelerated only insignificantly. The growth rates of previous upswing phases such as 1999, 2006 or 2010 (+1 percent and more) are currently not being reached yet – despite extremely optimistic sentiment indicators.

In June, the Economic Sentiment Indicator for the euro area published by the European Commission rose by 1.9 points to the highest level recorded since summer 2007. The survey substantiates the breadth of the upswing: sentiment improved in all five sub-components – industry, consumption, services, retail trade and construction – and in the four large economies Germany, France, Spain and the Netherlands; in Italy, by contrast, the indicator stagnated at a high level.

The unemployment rate in the euro area and the EU as a whole declined further as the economic situation improved. In June, it was 9.1 percent, 0.1 percentage point below the previous month's level and 1 percentage point below the year-earlier level. Hence the persistent downward trend observed since 2013 (record high exceeding 12 percent) continued. Nevertheless, the unemployment rate remains extremely high by international comparison, and still exceeds its level before the 2008-09 recession (7.3 percent) by 1.8 percentage points.

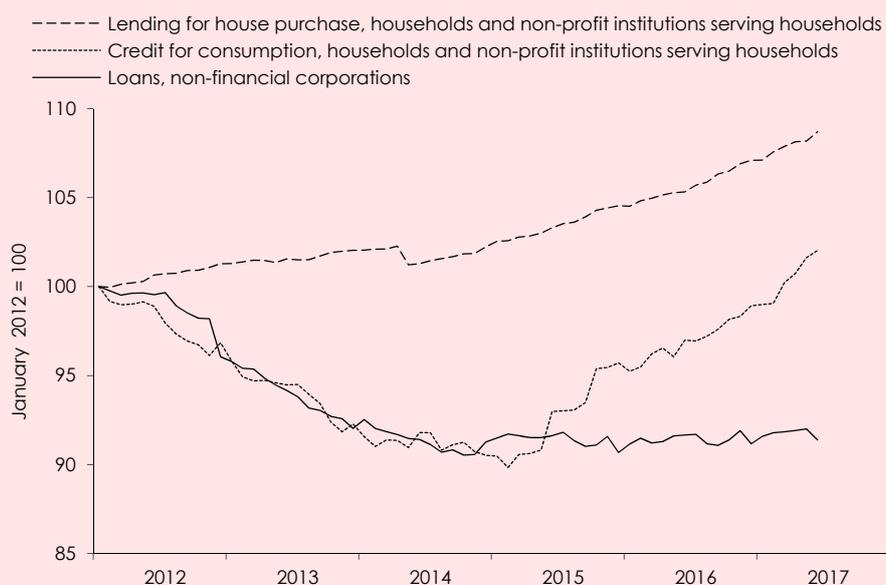
General inflation remained subdued despite the pick-up in economic activity, as crude oil price increases slowed again and the euro gained in value. Euro area inflation was still 2 percent at the beginning of 2017, and fell to 1.3 percent until June. According to Eurostat's flash estimate for July, inflation remained unchanged at 1.3 percent.

*In June 2017, the euro area unemployment rate hit its lowest level since 2009.*

## 1.2 Economic activity mitigates risk in banking sector

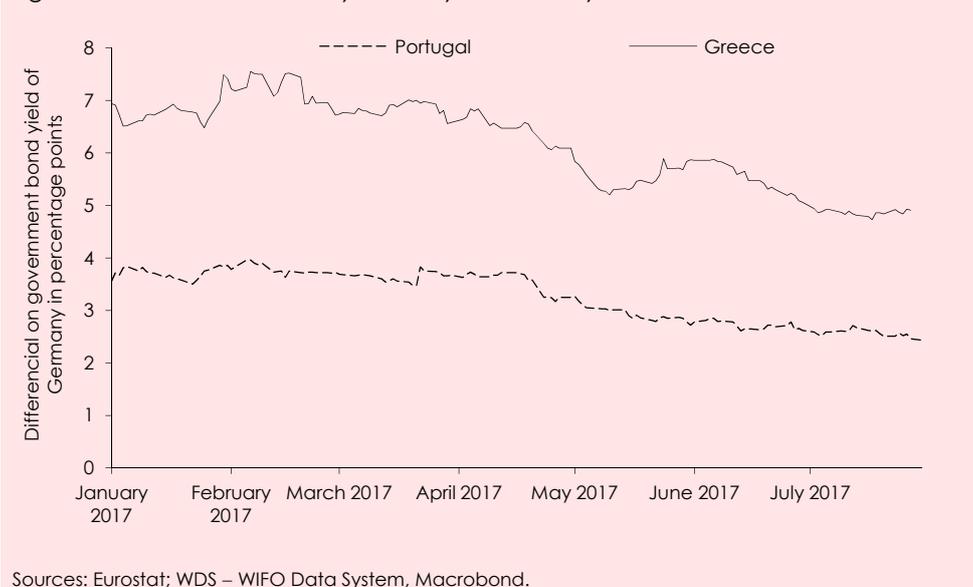
The global economic upswing helps to reduce the problems in the banking sector further. Credit institutions are able to improve their balance sheets, despite the still low interest margin owing to the ECB's zero-interest rate policy. On the one hand, the decline in distressed debt outstanding is easing the burden on them (as debtors' economic situation is progressively improving), and, on the other hand, banks are generating higher earnings owing to the growing demand for credit. Notably private households' demand for credits for consumption and for loans for house purchases continues to rise in the euro area (Figure 2), although many burdens – such as the negative interest rate for short-term deposits with the ECB – still persist.

Figure 2: Loans, euro area, consolidated



Sources: ECB, Macrobond.

Figure 3: Government bond yield, 10-year maturity – Maastricht criterion



Business for Austrian banks developed also much better than in the past. The reduced risk provisions requirement and the improving loan business were also crucial here.

With confidence rising on the back of the international upswing, trust in the solvency of some states is also increasing. The difference between government bond yields of some of the countries greatly affected by the financial market and economic crisis vis-à-vis German government bond yields has been shrinking gradually since the beginning of August 2017. Even the risk premium on Greek government bonds has declined from almost 7 percent in January 2017 to around 5 percent (Figure 3).

Hence Greece was able to place again government bonds on international financial markets for the first time: in July, the government successfully issued 3 billion € worth of a five-year bond with a yield of 4.625 percent.

*Greece returns to international bond market.*

## 2. Growth in Austria higher than in the euro-area average

According to WIFO's Flash Estimate, the trend-cycle component increased at a rate of 0.8 percent, adjusted for seasonal and calendar effects, in the second quarter of 2017. Hence growth was just as strong as in the first quarter. Adjusted according to Eurostat's method, the rate was +0.9 percent (first quarter of 2017 +0.7 percent), clearly higher than the euro area average of +0.6 percent.

Buoyant international demand was the main driver behind this positive development. The value of Austrian exports between January and May increased by 9.6 percent compared with the same period a year before. Notably the demand from the euro area picked up sharply (+12 percent). Until April, exports to Germany – Austria's main trading partner – grew by 8.3 percent, compared with a year before. Exports to Italy, Austria's third-most-important trading partner, rose by 7.9 percent. As for Austria's external trade with the USA, exports increased by 8.8 percent, those to China grew by 4.7 percent, while declines were recorded in the trade with Switzerland (-3.5 percent) and the UK (-3.4 percent).

*In the second quarter, Austria was among the euro countries with the highest economic growth.*

Total exports according to national accounts data increased by 2.0 percent in real terms, quarter-on-quarter, in the first quarter of 2017, and by so much as 2.4 percent in the second quarter. An important contribution to growth also came from investment demand, which, after a sharp quarter-on-quarter increase of 1.7 percent in real terms in the first quarter, rose by another 1.2 percent in the second quarter.

By contrast, the dynamism of private household consumption weakened somewhat. After increasing by 0.4 percent in real terms in the first quarter, it expanded by a mere 0.3 percent in the second quarter. This reflects the fade-out of the positive ef-

fects of last year's tax reform. However, the extremely favourable development of Austrian labour market conditions should ensure robust consumption growth also in the coming quarters.

Corporate sales increased sharply thanks to lively domestic and foreign demand. From January to May 2017, the industrial sector recorded a year-on-year increase of 10 percent, according to Statistics Austria. Construction registered an increase of 7.5 percent during the same period. The industrial production index registered a cumulative increase of 3 percent (working day adjusted) between January and May.

## 2.1 Business surveys signal further acceleration

The companies surveyed in WIFO's July Business Cycle Survey once again assessed their current situation more positively than in the past, with the respective index for the economy as a whole rising to its highest level in 10 years. The expectations index reached its highest level to date.

The good sentiment is apparent in many sectors of the economy. In manufacturing, the assessment of current business improved further in July. The companies surveyed stated that their average capacity utilisation rate was 85 percent, and around 82 percent reported sufficient or more-than-sufficient order book levels. Expectations, by contrast, stagnated at a high level in July. Manufacturers of intermediate products, capital goods and consumer goods presented a broadly positive picture overall.

The construction sector is also in splendid mood. While expectations for the time ahead did not rise further, the current situation index increased once again and now stands at its highest level; expectations had last been that positive in 2008.

Meanwhile, the economic momentum has also spread to services. Except in the hotels and restaurants sector, which is little responsive to cyclical trends, and the freelance services sector, both the assessments of the current situation and expectations for the time ahead reached their highest levels in years.

Apart from this extremely positive assessment by Austrian companies for the time ahead, WIFO's Leading Indicator also signals a further increase in momentum. In July, the index rose yet again; however, it still remained below the peaks reached in 2007 and 2010.

The buoyant economic activity not only benefits companies and private households, but also the general government. The decline in unemployment eases the burden on the government budget on the expenditure side. At the same time tax revenues rose by 6 percent between January and June 2017, compared with the same period a year before. A particularly sharp increase was registered in revenues from corporate tax (+21 percent), tax on capital gains (+13.4 percent), mineral oil tax (+11 percent) and turnover tax (+4.5 percent).

## 2.2 Good start into summer tourist season

In the first two months of the 2017 summer season (May and June), nominal tourism revenues reached 3,610 million €, according to estimates by WIFO, an increase of 6.8 percent from a year before. Adjusted for price changes, revenues rose by 4.9 percent. These two summer-season months normally account for close to one fourth of the number of nights spent during the six months of the entire summer season. However, the success of the 2017 summer season will largely depend on developments during the peak season, which accounts for half or more of the demand, with August carrying somewhat more weight (around 27 percent) than July (around 23 percent).

The by far sharpest increase in guest numbers registered in foreign source markets was for travellers from Russia (+37.0 percent, the first increase since the imposition of EU sanctions, but also from Poland (+20.9 percent), Romania (+18.6 percent) and Hungary (+11.0 percent). Nights spent by travellers from Germany, Austria's most important source market, also posted very dynamic growth of +8.2 percent, accounting for about half of the total increase in the number of nights spent. While average

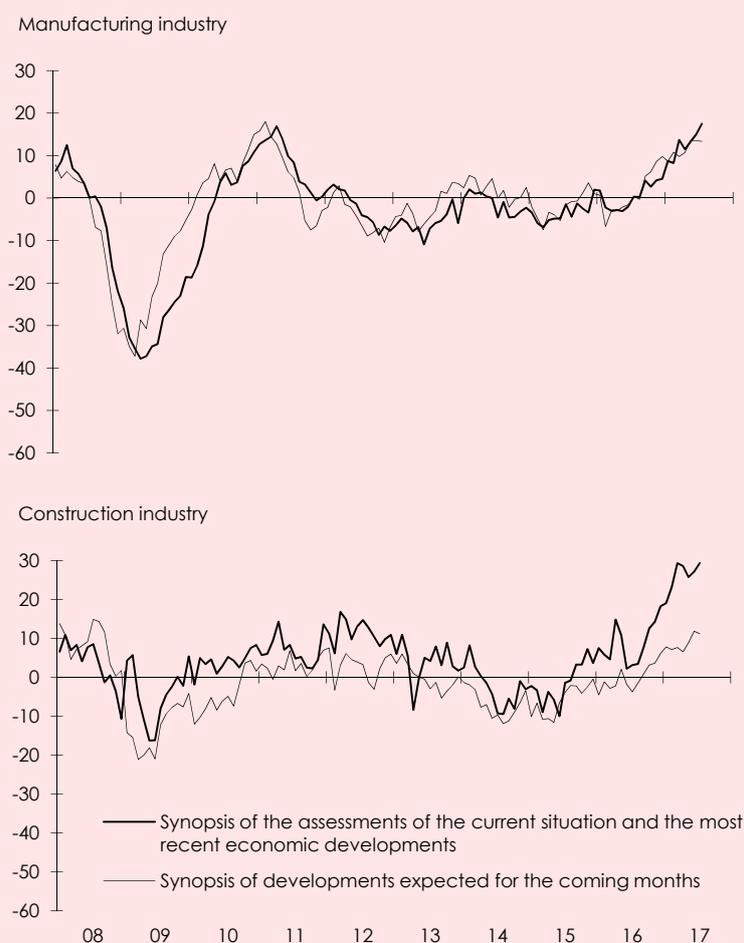
*WIFO's Leading Indicator signals further acceleration of GDP growth in the third quarter.*

*The number of nights spent by travellers from Russia rose briskly in May and June, while nights spent by British guests declined.*

growth (nights spent by foreign guests: +7.4 percent) was registered for the demand from the Czech Republic (+7.5 percent) and the USA (+7.2 percent), the demand from France (+4.8 percent), Italy (+4.4 percent) and Sweden (+4.3 percent) rose slightly, and the demand from the Netherlands (+1.2 percent) and Switzerland (+0.7 percent) posted noticeably weaker growth. A decline was registered only for guests from the UK (-2.4 percent) and Belgium (-4.1 percent) in May and June 2017.

Figure 4: 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.

### 2.3 Inflation rate stable at 1.9 percent in June

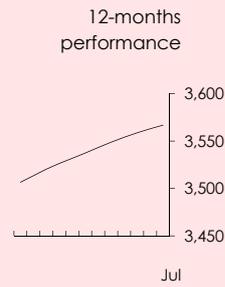
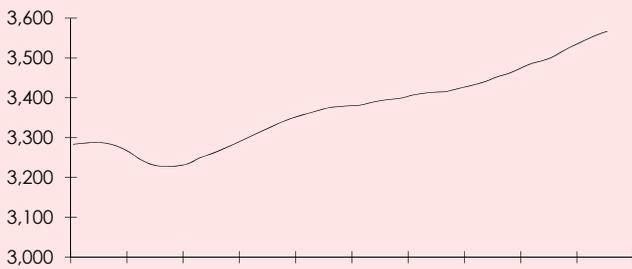
General inflation has flattened somewhat since the beginning of the year. While the reported inflation rate in February was 2.2 percent, reflecting the increase in the price of fuel, inflationary pressures diminished thereafter in tandem with the decline in crude oil prices on international markets.

In May and June, the inflation rate was only 1.9 percent. In June, fuel prices barely had an impact on inflation, according to Statistics Austria. At +3.0 percent year on year, restaurant services continued to be the strongest driver, contributing +0.29 percentage point to inflation.

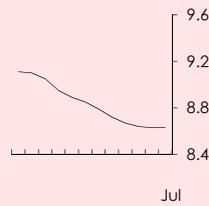
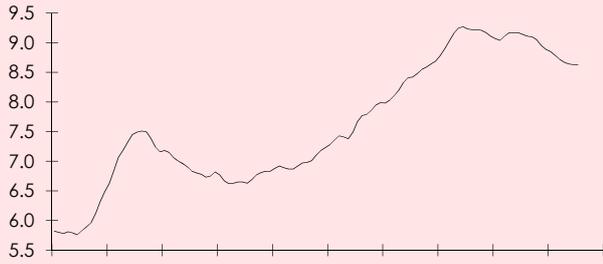
According to Statistics Austria, rent increases (May +3.8 percent, June +4.2 percent) contributed +0.21 percentage point to the inflation rate in June. Food was also considerably more expensive than a year before (June +2.3 percent, milk, cheese and eggs +4.3 percent), contributing +0.25 percentage point to the inflation rate.

Figure 5: Key economic indicators

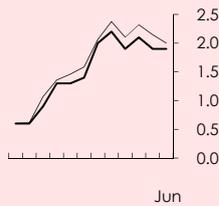
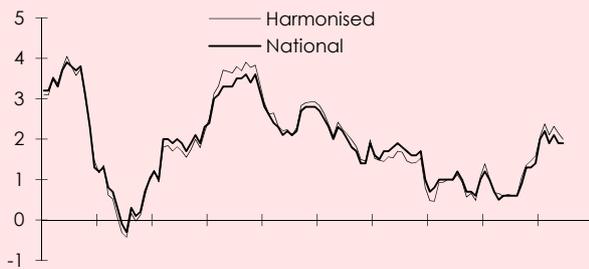
Persons in active dependent employment<sup>1</sup>, 1,000s, seasonally adjusted



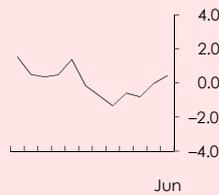
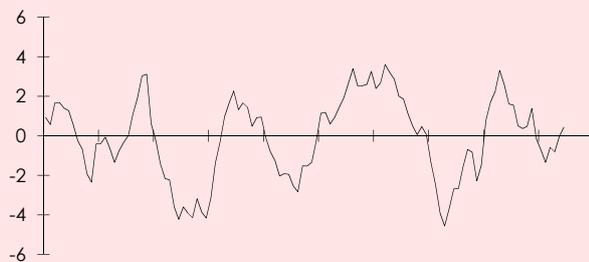
Unemployment rate, traditional Austrian method<sup>2</sup>, seasonally adjusted



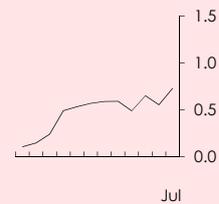
Consumer prices, year-to-year percentage changes



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



10-year central government bonds (benchmark), percent



Source: Public Employment Service Austria, Main Association of Austrian 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> As a percentage of total labour force excluding self employed, according to Public Employment Service.

The harmonised inflation rate for Austria was 2.0 percent in June (May 2.1 percent), again noticeably higher than the euro area average of 1.3 percent (May 1.4 percent). Hence, Austria, together with Hungary, recorded the sixth-highest price increase of all 28 EU countries.

#### **2.4 Positive trend reversal on labour market continues**

The good performance of the economy continues to have a positive effect on the Austrian labour market. The number of persons in active dependent employment increased by 2 percent, year on year, in July (+70,000), the same rate as in June, according to estimates by the Federal Ministry of Labour, Social Affairs and Consumer Protection (BMAK).

As a result, the number of persons registered as unemployed with the Public Employment Service Austria (AMS) dropped by 14,100 to 307,200, and the unemployment rate in July is estimated at 7.6 percent, unchanged from the previous month. Adjusted for seasonal effects, there were also no changes compared with the previous month (8.6 percent).

The demand for labour continues to rise briskly. In July, the number of job vacancies registered with the Public Employment Service Austria rose further to 65,000. At +21,200, the increase was even higher than in June (+16,800 jobs).