

Marcus Scheiblecker

Economic Environment for Austria Remains Difficult

Business Cycle Report of November 2015

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According to WIFO's Business Cycle Survey, business sentiment in Austria has improved further, but still does not hint to a marked upswing. Consumption has remained sluggish, whereas investment demand has picked up recently. The Austrian economy is faced with contradictory stimuli from abroad: economic slack in key emerging market economies is exerting a dampening effect, while exports to the USA are growing vigorously. In the EU as a whole and the euro area, demand for Austrian products is growing only tepidly.

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The majority of leading indicators for the assessment of future economic conditions suggest that the moderate economic recovery will proceed. But there is still no indication of a substantial acceleration. Domestic investment is increasing, however, and exports are also strengthening.

In the first eight months of 2015 merchandise exports to emerging market economies – notably those to Russia – declined. Lively export demand from the USA offset this drop in exports. Merchandise trade with the EU remained subdued, however, accelerating somewhat only in June when trade with Germany picked up.

Weak private consumption weighed on the economy also in the third quarter. Neither the decline in energy prices nor the upcoming relief of household incomes through the tax reform have so far been able to stimulate private consumption. Consumer confidence fell below the troughs registered in recent years. This suggests that the outlook for the coming months remains subdued.

The tourism sector experienced a very successful summer season, according to data available so far. The number of guest arrivals reached a new peak, and although expenditure per night spent declined further, the tourism industry also recorded a marked sales increase compared with the same period a year before.

Inflation declined as a result of the renewed plunge in the prices for energy commodities. However, owing to the continuing vigorous increase in rents and in the cost of services related to the provision of food and drink, it remained relatively high by international standards at +0.6 percent (HICP) in September – the HICP fell both in the euro area (-0.1 percent) and in Germany (-0.2 percent).

The situation in the Austrian labour market remains tense. Notwithstanding a 1 percent increase in the number of persons in dependent active employment compared with a year before, unemployment rose further, according to the Public Em-

ployment Service Austria – AMS (+29,100 to 339,400 persons). With economic activity gradually improving, the number of job vacancies registered with the Public Employment Service Austria (AMS) has been rising again since May.

According to the Public Employment Service Austria, the unemployment rate rose from 8.2 percent in September to 8.7 percent in October, which was considerably higher than the rate recorded a year before (8.1 percent). Based on data adjusted for seasonal effects, the rate has stagnated at 9.3 percent in recent months, however. The EU-wide harmonised rate remained unchanged at 5.7 percent in September, seasonally adjusted; hence Austria, together with Estonia had the fifth lowest rate of all EU countries.

1. Global economic developments remain uneven

In the BRICS countries (Brazil, Russia, India, China, and South Africa), weak demand for commodities and the related fall in prices continue to be a major strain on the economy. GDP contracted in Brazil, Russia and South Africa in the second quarter of 2015, while China and India saw their economies expand at the relatively robust pace of +1.8 percent and +1.6 percent, respectively. For China, however, business cycle surveys signal some loss in momentum. According to the first estimate for the third quarter, GDP rose by 1.8 percent, but the annual rate of change was the lowest recorded since 2009. The exchange rate and stock prices have recovered only little from their slump in August.

The demand from the USA is currently an important pillar of Austria's export industry. The US economy has remained very resilient so far. The upward trend still persisted in the third quarter, according to the first GDP estimate. Following an extraordinarily brisk expansion of 1 percent in the second quarter, growth was somewhat slower at 0.4 percent than the average for previous years. Industrial production basically stagnated until September at the pre-crisis level of 2008.

Meanwhile, however, some indicators signal a deterioration in the outlook for the coming months: on the one hand, the ISM Purchasing Managers' Index dropped in September and October to a reading of just above 50 points, the threshold indicating an expansion of industrial production. On the other hand, consumer surveys conducted by the Conference Board and the University of Michigan have also been slowly trending down since the beginning of 2015, suggesting a dampening of consumer demand, an extremely important factor for the US economy.

The US central bank so far has not ended its zero interest rate policy as announced a few months ago, with the federal funds rate standing at close to 0 percent since the end of 2008. Whether or not it is to be increased will be studied in a meeting in December. Economic developments and labour market conditions would justify a considerably higher interest rate, but the inflation rate has been hovering around 0 percent since the beginning of 2015. After +0.2 percent in July and August 2015, annual inflation once again dropped to 0 percent in September.

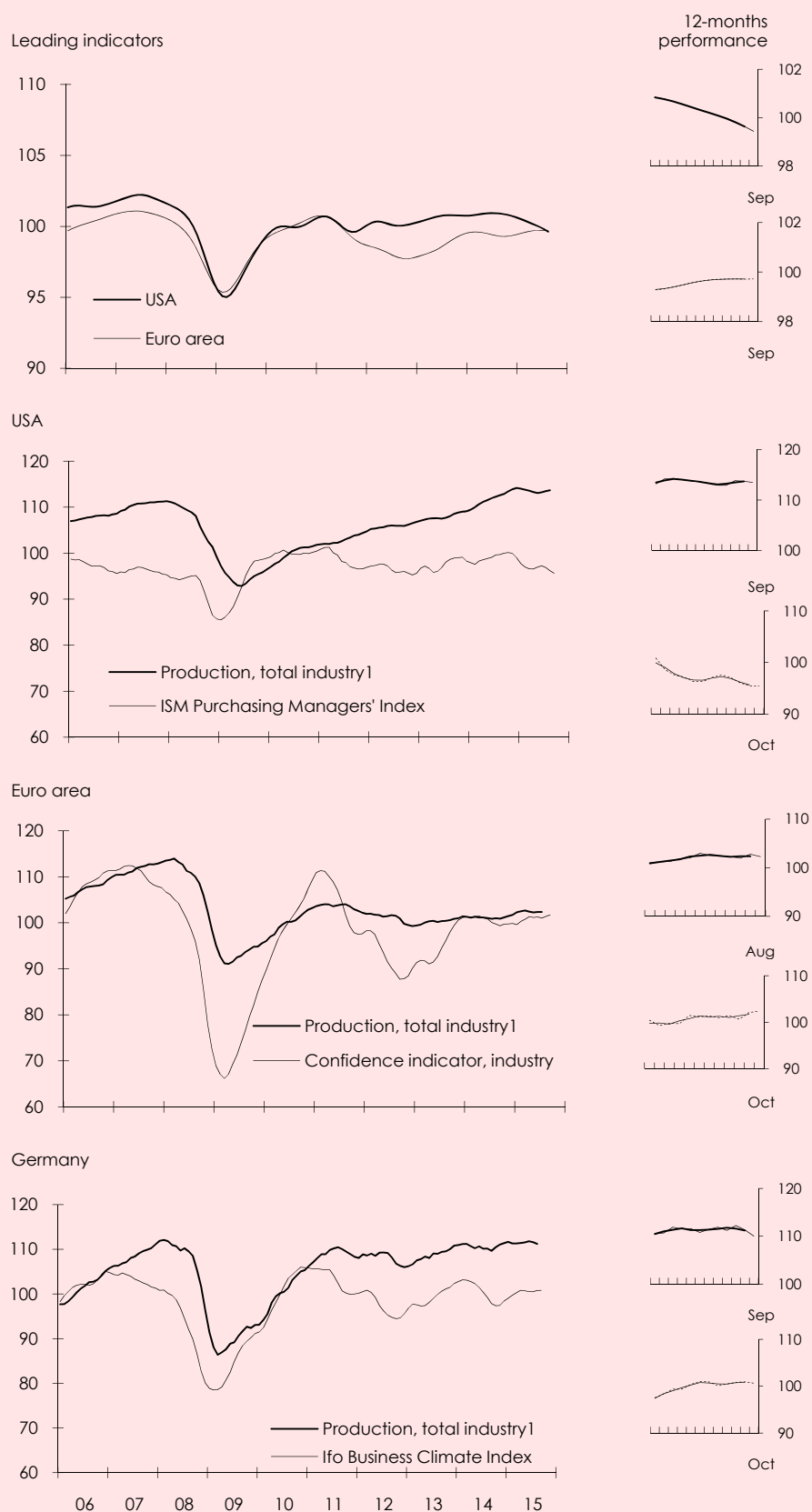
Whether or not the relatively loose monetary policy in view of the good economic situation currently helps the formation of price bubbles in capital asset markets is very difficult to judge. According to the Case-Shiller Home Price Index, prices have followed an upward trend since spring 2012, but have not yet reached the level of 2006. Besides, there is no sign of a substantial acceleration of inflation as in 2004 and 2005, which usually immediately precedes the bursting of a price bubble. On the contrary, the growth momentum has even slowed since mid-2014.

Stock prices, which had risen owing to the low levels of interest rates, also appear to have eased. In October, S&P 500 Index stock prices stood at about the same level as at the beginning of the year. The secondary market yield for 10-year government bonds (benchmark), at 2 percent at the end of October was lower than the average for the last five years.

The emerging market economies remain mired in crisis. The US economy continues to expand but is showing first signs of a loss in momentum.

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. – ¹ Excluding construction.

2. Europe experiences modest economic improvement

As the data on industrial production in the EU as a whole and the euro area available until August 2015 show, growth was rather subdued until the summer, with the individual EU countries presenting a highly mixed picture: in Greece and Finland, production has been following a downward trend for years. By contrast, a persistently rising trend is apparent for Hungary, Poland and Slovakia. Industrial production has only recently been gaining momentum in Slovenia, Portugal, Sweden, Spain and notably Ireland, while it stagnated until August in the other EU countries.

In October 2015, the business sentiment survey conducted in the industrial sector showed an essentially unchanged picture for both the EU as a whole and the euro area. Hence the economy should continue its modest upward trend in the coming months. Firms' assessments of economic activity have been improving steadily in recent months only in Austria, Spain, Sweden and France, while they have deteriorated markedly only in the UK.

In construction, assessments have improved constantly in the EU as a whole and the euro area since the end of 2012, and in October 2015 the respective index in the euro area climbed to its highest level since September 2008. This upward trend is broad-based, with sentiment trending to deteriorate only in a few countries such as the UK and France in recent months.

The recovery of private consumption – a mainstay of economic growth in the euro area in recent months – may have lost some strength since the summer. Consumer confidence, which at the beginning of 2015 had approached its peak before the 2008-09 crisis, has been deteriorating again since the second quarter, notably in Germany and Austria. Real retail sales (excluding cars) still rose vigorously in the EU as a whole until September 2015.

Owing to the beginning economic revival in the euro area, the unemployment rate fell steadily from its peak of more than 12 percent in spring 2013 to 10.9 percent in August 2015 and 10.8 percent in September. No EU country registered an increase in the rate. Youth unemployment also fell again to 22.1 percent in September. In Greece, Spain and Italy it still remained above 40 percent, however.

The ECB has for some time been taking extraordinary measures to push ahead with its monetary policy objectives and to bolster economic activity, but with no effect so far. Lower commodity prices and weak aggregate demand once again dragged euro area inflation into negative territory in September – the inflation target being below, but close to, 2 percent. According to a preliminary flash estimate by Eurostat, inflation stood at 0 percent in October. Strong deflationary trends persist in Cyprus, Romania, Spain, Slovenia and Greece, while marked price increases have been registered only in Malta, Sweden, Portugal, Belgium and Austria.

All over Europe business surveys point to some further modest pick-up in momentum, but the key areas of growth appear to be shifting to other countries.

3. Investment activity and exports provide first impulses

According to preliminary calculations, GDP in Austria grew by 0.3 percent in the third quarter of 2015, the same pace as in the previous quarter. This corresponds to a year-on-year increase of 1 percent, but there was one extra working day compared with the third quarter of 2014.

Private consumption has been stagnating for more than two years. So far, neither the weak inflationary pressures nor the prospect of the entry into force of tax cuts at the beginning of 2016 have prompted households to increase their spending. This is also reflected in the continued sluggish growth of real retail sales (excluding cars).

In October, consumer confidence dropped to its lowest level since the 2008-09 crisis; hence a pick-up is not in sight. But the influx of refugees should generate additional demand.

Notwithstanding the continued difficult situation in many foreign markets, exports picked up in the third quarter and grew by 1.4 percent in real terms compared with the previous quarter, according to the National Accounts. However, the expansion

The Austrian economy once again grew by 0.3 percent in the third quarter. Manufacturing activity has been accelerating further, albeit only moderately so far.

of investment went hand in hand with a sharper rise in imports (third quarter +1.6 percent in real terms).

The strengthening of economic activity from spring onwards became apparent notably in the pick-up of the demand for capital goods. The weakness of this demand component had considerably held back growth of the Austrian economy¹ in recent years. The restraint of Austrian companies had extended to both equipment and buildings.

Investment has been picking up noticeably again since the second quarter of 2015. Expenditure on gross fixed capital formation rose by 0.5 percent, quarter on quarter, in both the second and the third quarter. Notably equipment investment recovered, while construction investment declined further.

The pick-up in exports and equipment investment is also reflected in a modest rise in manufacturing value added (second quarter +0.5 percent in real terms, third quarter +0.6 percent). Positive contributions to growth also came from the services sector: trade, transport, and hotels and restaurants posted a 0.3 percent increase in real value added, while a 0.6 percent rise was registered in real estate and housing.

The economic weakness in the euro area continues to be a major strain on developments in the Austrian export industry. Since the beginning of 2015 the value of exports has risen by 2.4 percent overall (January to August). Developments have been heterogeneous across the euro area, and have diverged considerably also in the group of third countries.

While growth of merchandise exports to EU countries remains sluggish, the vigorous expansion of exports to the USA is counterbalanced by a decline in the demand from emerging market economies.

Table 1: Contributions of selected countries to growth of Austrian merchandise exports

	First quarter of 2015	Second quarter of 2015	January to August 2015
	Percentage points		
USA	+ 1.2	+ 1.1	+ 1.2
Germany	+ 0.5	+ 0.5	+ 0.8
Switzerland	+ 0.9	- 0.2	+ 0.5
Poland	+ 0.4	+ 0.4	+ 0.4
UK	+ 0.2	+ 0.2	+ 0.2
Spain	+ 0.2	+ 0.3	+ 0.2
Italy	+ 0.0	+ 0.2	+ 0.1
China	- 0.1	- 0.1	- 0.0
France	- 1.5	- 0.3	- 0.6
Russia	- 1.0	- 0.9	- 0.9
	Year-to-year percentage change		
Total exports	+ 1.1	+ 2.3	+ 2.4

Source: Statistics Austria, WIFO calculations.

Merchandise exports to the USA as well as to the UK, Poland and Switzerland proved to be a major mainstay of the export industry during that time, while the demand from emerging market economies declined. The value of cumulated exports to the USA until August increased by more than 19 percent, while the value of exports to the UK rose by more than 6 percent (Poland +14.8 percent, Switzerland +10.5 percent). This was counterbalanced by a sharp decline in the trade with Russia (-38 percent) and Ukraine (-46 percent) brought about by the economic crisis in these countries and the sanctions imposed on Russia. However, these two countries currently account for less than 2 percent of Austrian merchandise exports. China's economic problems also dampened Austrian merchandise exports, with the value of cumulated exports from January to August 2015 to China (2.5 percent of Austrian merchandise exports) declining by almost 2 percent.

¹ For extent and causes of this development see Fenz, G., Ragacs, Ch., Schneider, M., Vondra, K., Waschiczek, W., "Causes of declining investment activity in Austria", OeNB, Monetary Policy & The Economy, 2015, (Q3/15).

Measured by the export share-weighted change of exports, the USA in each quarter since the beginning of 2015 has been contributing more than 1 percentage point to the growth of total merchandise exports; exports to the USA were an important pillar of the export industry until the second quarter (Table 1). This offset the sharp decline in the trade with Russia. Italy, Austria's second most important trading partner, provided almost no stimulus in the first eight months. The weak demand from France also had a clearly dampening effect during that period, with special effects in the trade with pharmaceuticals partly playing a role here.

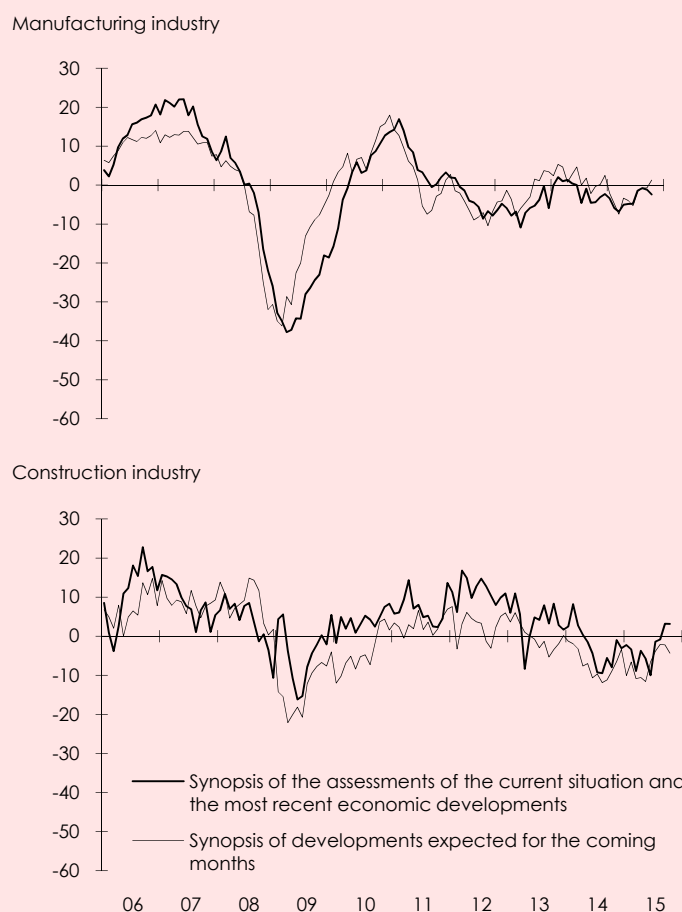
The improvement in the dynamism of exports in mid-2015 was again increasingly driven by demand from Germany, Austria's main trading partner. However, until August Germany's contribution to growth did not yet measure up to that of the USA.

The economic situation is set to improve further in the coming months. In the WIFO Business Cycle Survey of October, both the assessment of the present situation and expectations regarding future developments suggest a pick-up in economic activity. The recovery should proceed in the first quarter of 2016, but should remain moderate, as the results of partial surveys in manufacturing show. The constant improvement in the assessment of the present situation observed in the construction sector in recent months has come to a halt for the time being, while companies have again become more sceptical with respect to future developments.

WIFO's Leading Indicator points to a sustained moderate pick-up in economic activity in the coming months.

Figure 2: Results from the WIFO Business Cycle Survey

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



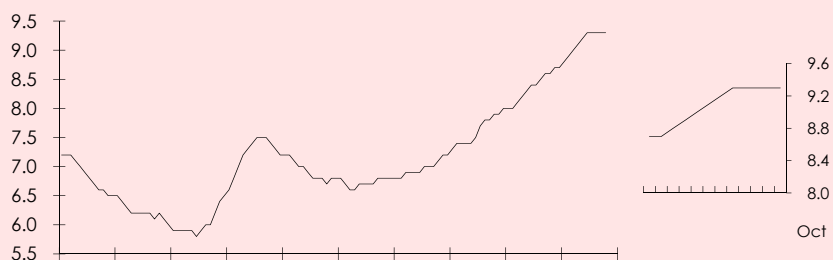
Source: WIFO Business Cycle Survey. Data refer to index points (percentage points) between +100 and -100. Values above 0 imply positive expectations, values below 0 indicate negative expectations.

Figure 3: Key economic indicators

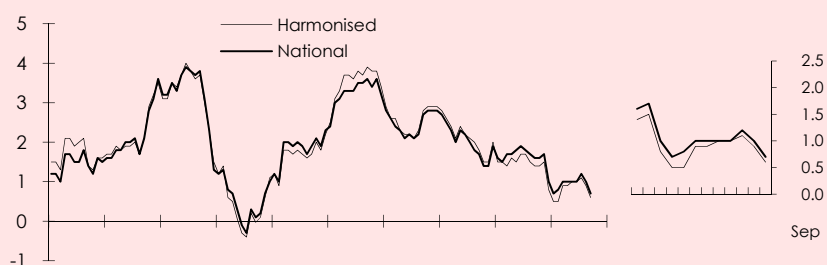
Persons in active dependent employment¹, (1,000), seasonally adjusted



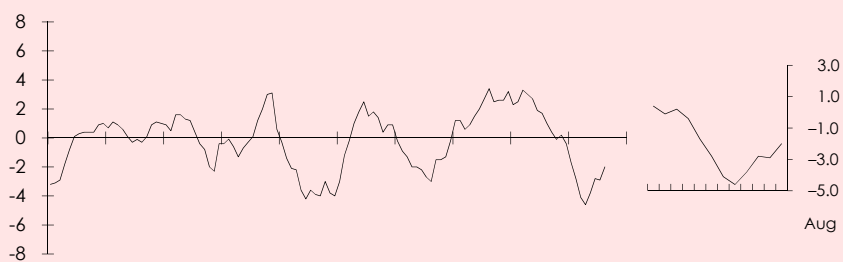
Unemployment rate, traditional Austrian method², seasonally adjusted



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, Federation of Austrian Social Security Institutions, Oesterreichische Nationalbank, Statistics Austria, WIFO calculations. – ¹ Excluding parental leave, military service, and unemployed persons in training. – ² As a percentage of total labour force excluding self employed, according to Public Employment Service.

The renewed rise of Bank Austria's Purchasing Managers' Index in October also signals a further improvement in the economic situation. Given its steady increase in recent months, WIFO's more broad-based Leading Indicator likewise points in this direction. This index weights 10 indicators from the real economy and the financial sector, half from Austria, the other half from abroad.

3.1 Summer tourism season successful so far

Guest arrivals between May and September 2015 grew at the vigorous rate of 7.2 percent, reaching 19.3 million, an all-time high; previously the number of nights spent (62.5 million, +3.9 percent) had been exceeded only in the same period in 1994 (64.4 million). Growth was largely driven by demand from abroad (+4.5 percent), with foreign guests accounting for around 70 percent of total nights spent. The number of nights spent by domestic guests also increased compared with a year before, but at +2.5 percent rose at a clearly more modest pace.

Revenue grew somewhat more slowly at +3.2 percent, reflecting the continuing decline in expenditure per night spent; it reached a total volume of € 9,810 million. In real terms, sales exceeded the year-earlier level by 2.2 percent.

Notably city tourism expanded, as already in the more recent past. Among the Länder, Vienna posted the highest increase of all in the number of nights spent (+8.3 percent)², according to data on the summer season available so far (May to September). Apart from the cities, the increase in demand also benefited summer tourism in the Alpine regions in the west (nights spent in Tyrol +4.7 percent, Salzburg +4.6 percent). Slightly below average growth in the demand for overnight stays was registered in Upper Austria (+3.7 percent) and Styria (+3.4 percent), while the other Länder posted only modest gains (Carinthia +0.9 percent, Burgenland +1.0 percent, Lower Austria +1.4 percent, Vorarlberg +1.5 percent).

Particularly vigorous increases were registered in the demand from the USA (+12.4 percent), the Czech Republic (+11.6 percent), Sweden (+10.4 percent), Denmark (+8.4 percent) and Poland (+7.9 percent). The increase in the nights spent by guests from Switzerland and Italy (+6.1 percent each) and from the UK (+5.8 percent) also exceeded the average for nights spent by foreigners (+4.5 percent). This development was helped in part (USA, Switzerland, the UK) by the fall in the euro exchange rate.

Growth in the demand from Germany and the Netherlands, the most important source markets for Austrian tourism, (together accounting for 60 percent or more of nights spent by foreigners and more than 40 percent of the total demand, respectively) was also positive at +1.8 percent and +2.7, respectively. By contrast, a slight decline was recorded in the number of nights spent by guests from Belgium (-1.1 percent) and France (-2.2 percent), while a massive drop was registered on the Russian market (-27.0 percent), which is suffering from the plummeting exchange rate of the rouble, the economic crisis, and the EU sanctions.

3.2 Inflation rate in Austria clearly below average

The consumer price index rose by +0.7 percent in September, considerably more slowly than in August (+1 percent). The renewed plunge of fuel prices for the first time since February 2015 pushed headline inflation below the 1-percent mark. According to Statistics Austria, fuel prices were down by 16.8 percent compared with a year before.

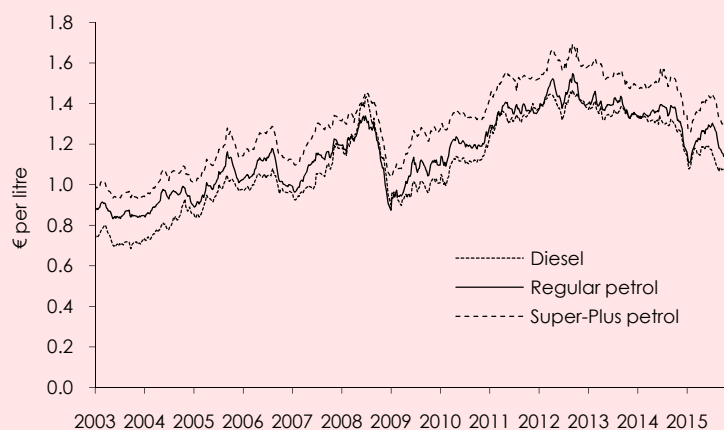
According to the fuel-price monitoring by the Ministry of Science, Research and Economy (weekly checks at domestic petrol stations), the prices of diesel and regu-

The inflation rate in Austria fell from 1.0 percent to 0.7 percent in September.

² In May, the number of nights spent in Vienna increased by a mere 2.3 percent, in spite of the staging of the Eurovision Song Contest and in spite of the early timing of Pentecost. Hence the event may have suppressed part of the usual Pentecost tourism. However, in June and July Vienna recorded two-digit growth rates (June +10.3 percent, July +12.1 percent). A causal assessment of the (short- and long-term) impacts of this major event on tourism is only possible by means of complex statistical methods.

lar petrol on 26th October 2015, the reporting date, again hit the lows recorded at the beginning of 2010. Super-Plus petrol was last cheaper only in October 2009.

Figure 4: Fuel prices in Austria



Source: Federal Ministry of Science, Research and Economy, Fuel-price monitoring.

The largest contribution to inflation came from services related to the provision of food and drink (in the "restaurants and hotels" category) with a year-on-year increase of 3.5 percent. Rent increases of 4 percent over the year also continue to act as a price booster, with inflation consequently remaining high compared to that in other EU countries.

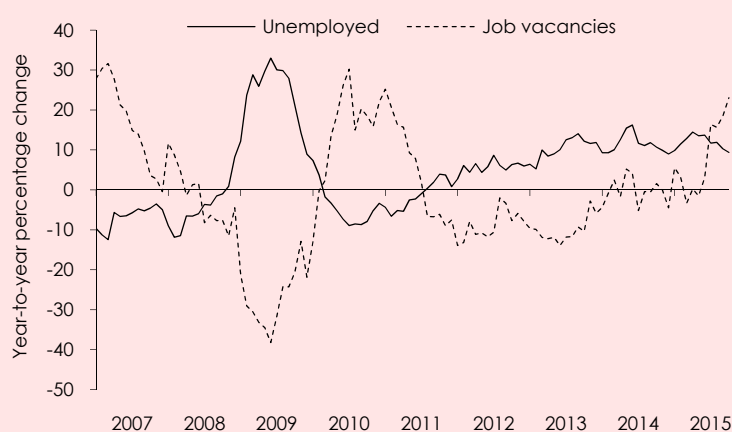
The EU-wide harmonised index of consumer prices rose at +0.6 percent in Austria, somewhat more moderately than the CPI, but inflation remains high compared to that in other EU countries. The inflation differentials vis-à-vis the euro area average and Germany persist (September +0.7 and +0.8 percentage points, respectively).

3.3 Labour market development largely split

The underlying momentum of the Austrian economy is still too weak to be able to completely absorb the labour force. Against this background, the number of persons in dependent active employment rose also in October (+34,000, +1.0 percent compared with a year before), while on the other hand the number of persons registered as unemployed with the Public Employment Service Austria (AMS) also increased (+29,100, +9.4 percent), primarily owing to growing numbers of older and foreign unemployed persons; cutbacks in vocational training also contributed indirectly to this development (-7,400).

While unemployment continues to grow briskly, employment has increased further, and the number of job vacancies has also begun to rise again recently.

Figure 5: Unemployed persons and job vacancies in Austria



Source: Public Employment Service Austria, WIFO calculations. Unemployed: AMS definition.

Notwithstanding positive signals owing to the gradual pick-up in economic activity, the month-on-month comparison of seasonally adjusted data does not yet indicate a trend reversal: in October 2015, the number of unemployed persons increased by 1,200 (+0.3 percent) compared with a month earlier.

For the first time since mid-2011 the rates of change in job vacancies exceeded those in the number of unemployed (Figure 5) from May 2015 onwards. Compared with a year before, the number of job offers rose by 6,000 (September +5,300), while the month-on-month increase was 820 (September +980). The number of apprenticeship vacancies was also higher than a year before.

The unemployment rate rose to 8.7 percent in October (September 8.2 percent). However, seasonal effects played a dominant role here. As in recent months, no month-on-month increase was apparent in the seasonally adjusted rate.

The harmonised unemployment rate according to Eurostat remained unchanged at 5.7 percent in September. Hence Austria, together with Estonia, ranked fifth among EU countries, after Germany (4.5 percent), the Czech Republic (4.8 percent), Malta (5.1 percent) and the UK (5.3 percent).