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## Business Activity More Muted at the Start of the Year

**From late 2004 to January, domestic industrial manufacturers turned more cautious in judging their order situation. Confidence has also weakened slightly with regard to the longer-term business outlook. While the pace of exports has slackened somewhat, signs for a strengthening of domestic demand remain vague.**

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The WIFO business survey for the first quarter 2005 shows that the cyclical recovery has lost some momentum around the turn of the year. While the firms included in the sample still gave a positive judgement on their current business situation, the share of respondents calling their order situation "very good" has declined from the previous survey. The balance of positive over negative assessments concerning the further trend of output was +8 percentage points, slightly below the average for the last five quarters. Optimism has also become clouded since last autumn, as far as the outlook for the next three months is concerned. One reason is the slackening pace of expansion of foreign trade. The level of export orders has been rated lower in the business survey. Apart from weaker demand growth from major European trading partners, the significant rise of the euro vis-à-vis the dollar has been a major factor.

Global economic conditions remain rather uneven. While the US economy continues to enjoy lively growth, the recovery in the euro area is hardly gaining strength. Real GDP in the USA rose by 0.8 percent from the previous period in the fourth quarter 2004. Private consumption remained buoyant, leading to substantially higher imports. US exports declined, however, apparently not benefiting from the weaker dollar.

The economy of the EU and of the euro area each gained a modest 0.3 percent in the third quarter, down from 0.5 percent in the previous three months. Unlike in the USA, domestic demand provided virtually no positive contribution to growth, all support coming from exports. Of particular concern is the persistent sluggishness of private consumer demand. Also for the fourth quarter, the indicators do not suggest a revival: retail sales volumes in the euro area were up by only 0.5 percent year-on-year in December 2004, after 0.2 percent in November.

For Germany, the data do not yet show a vigorous rebound from the stagnation of activity in the last years. Although positive growth of GDP has been recorded in 2004 for the first time after three years, the rate of +1.7 percent has been modest given the strong external environment and a sizeable positive calendar effect.

The slackening of activity abroad may lead to greater caution in domestic firms' investment intentions. For 2005, according to the WIFO survey, companies in manufacturing, public utilities and construction envisage no increase in their investment levels from last year. However, the assessment of the trend in investment is blurred by the frontloading of projects into 2004 induced by temporary tax concessions.

Domestic demand in Austria recovered gradually in the second half of 2004. Construction investment and output of the construction sector benefited from tax incentives. Retail sales are likely to grow at an annual pace of 2 percent in volume since the middle of 2004, following their stagnation in the first semester.

With lively exports and a revival of domestic demand, economic growth should have reached a pace where a further deterioration on the labour market could be avoided. Already, healthy employment gains are being recorded, with the number of dependent active employees in January 2005 up by 38,000 from last year. The favourable business situation in manufacturing also implies that no further full-time jobs are being lost. Nevertheless, unemployment remains significantly higher than one year ago, on the back of an increase in labour supply. The latter is driven by several factors, such as a higher number of seasonal workers, more foreign workers granted access to the labour market because of the duration of their residence in Austria, immigration from the EU 15 or the raise in the retirement age.