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Austrian Economy Growing Tepidly in First Half of 2015

Business Cycle Report of September 2015

Austrian Economy Growing Tepidly in First Half of 2015. Business Cycle Report of September 2015
GDP growth in Austria accelerated marginally to 0.3 percent in the second quarter, compared with the previous quarter. Aggregate domestic and foreign demand once again did not provide any substantial impetus to economic activity in Austria. Notably the persistently weak investment performance determined economic developments in Austria also in the first half of the year. Leading economic indicators essentially suggest that the tepid recovery will proceed also in the following quarters.

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For definitions used see "Methodological Notes and Short Glossary", http://www.wifo.ac.at/wwadocs/form/WIFO-BusinessCycle Information-Glossary.pdf • All staff members of the Austrian Institute of Economic Research contribute to the Business Cycle Report. • Cut-off date: 4 September 2015.

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Following weak expansion early in the year, global economic growth appears to have accelerated only little in the spring of 2015. A dominant factor contributing to the slight improvement was the pick-up in economic activity in the USA. In China, the moderation in growth observed previously did not continue in the second quarter, but the risks of a sharper slowdown remain high. The recovery in the euro area proceeded, despite a renewed escalation of Greece's sovereign debt crisis. The economic picture darkened not only in Russia, but also in Brazil, which fell into a deep recession. Hence the global economy grew only modestly overall in the first half of 2015.

Growth of the Austrian economy remains barely above stagnation. GDP expanded by 0.3 percent in the second quarter, compared with the previous quarter; the unadjusted figure exceeded the year-earlier level by 0.5 percent in the second quarter. Growth remains below the euro area average.

Aggregate domestic and foreign demand failed to provide any substantial impetus to economic activity in Austria also in the second quarter. Notably the persistently weak investment performance determined economic developments in Austria in the first half of the year. For more than a year now, the contribution of private investment to growth has been negative or nil. The growth momentum of government consumption has been only marginally stronger, with overall consumption consequently increasing by a mere 0.1 percent.

Leading economic indicators principally suggest that the tepid recovery will continue also in the coming months. The results of the WIFO Business Cycle Survey of August still show a slightly below-average assessment of the situation by Austrian companies. However, the outlook for the next few months improved somewhat for the third consecutive time.

The inflation rate was 1.1 percent (HICP) in July, once again markedly higher than the euro area average (0.2 percent). The differential has increased further recently.

Employment is rising continuously, despite weak economic growth. With just under 3.5 million people in dependent active employment, it was up by almost 1 percent in August compared with a year before. Just under 330,000 persons were registered as unemployed with the Public Employment Service, which was an increase of 35,000 or almost 12 percent from a year before. According to the national method of calculation, the unemployment rate reached 8.4 percent in August (July 2014: 8.1 percent).

1. Economic slowdown in emerging market economies leaves its mark on global activity

Weak activity in emerging market economies, the expansion of which until recently drove world economic growth, has become a risk to global growth: both Brazil and Russia are in recession, while China's economy has lost considerable momentum compared with previous years.

While old risks persist – debt crisis in the euro area, pending interest rate change in the USA –, sluggish growth in emerging market economies poses a new risk. For a long time the latter were the engine driving the global economy. After the financial market crisis of 2008, their expansion supported global growth, but the dependence on these markets also increased. This may now entail substantial negative effects on the global economy: with China, Russia and Brazil, three important emerging market economies are facing economic difficulties. A tightening of monetary policies in advanced economies may exacerbate the problems further.

The reasons for the weak growth of emerging market economies are complex: the expansion of global trade falls short of expectations, commodity prices have dropped markedly, and in many countries governments lack sufficient capacity to act to counter weak growth. In addition, the pending interest rate change in the USA (increase of key interest rate) will lead to a worsening of financing conditions, with consequently credit growth slowing further. The depreciation of the Chinese currency renders the environment for China's trading partners even more difficult. This phase of weakness of emerging market economies is likely not just a dip in economic activity, but also due to structural problems.

In 2014, major emerging market economies (e.g. China, Brazil) did implement economic programmes to support growth. However, most of the effect of these programmes fizzled out owing to on-going capital outflows. A tightening of monetary policy in the USA may lead to an increase in the volume of capital outflows and therefore weaken growth in emerging market economies further.

Economic weakness in Brazil intensifies.

Following stagnation already in 2014 and a decline by 0.7 percent in the first quarter of 2015, GDP contracted by 1.9 percent in Brazil, Latin America's largest economy, in the second quarter of 2015, throwing the country into recession. Compared with the first half of 2014, the economy even shrank by as much as 2.1 percent. The recession does not come as a surprise: the government had reacted with excessive public spending to the 2008-09 global financial crises. Ailing sectors were provided with subsidised loans, while private consumption was stimulated by means of tax allowances. At the same time the government decreed an energy price freeze. As, moreover, wages rose amid stagnating productivity, Brazil's industry became increasingly less competitive internationally. The correction of energy prices by up to 50 percent at the beginning of 2015 is now weighing on the ailing industrial sector. The car industry is particularly affected, and reacts with mass dismissals to the sharp fall in sales. Planned investments have been stopped. In addition, consumption of the already heavily indebted private households plummeted in the second quarter as a result of quickly rising unemployment and an inflation rate of around 10 percent. The government currently does not have any financial leeway to counter this development: the double-digit plunge in tax revenues has sent the public sector into a precarious state. Instead of running a primary surplus as planned to pay credit rates, the government has increasingly had to take out new loans recently. While Brazil's total debt is relatively low at around 66 percent of the country's gross domestic product, interest rates on government bonds average around 13 percent. Measured by its size relative to GDP, the interest burden to be borne by Brazil is therefore higher than that of Greece. To fight escalating inflation, the central bank recently raised the key interest rate to 14.25 percent. As a result, the already sharply slowing momentum in Brazil's economy is being dampened further.

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. US economy growing vigorously in second quarter

According to a second official estimate, US real GDP rose by at least 0.9 percent on a seasonally adjusted basis in the second quarter of 2015, compared with the previous quarter. The estimate still shows modest growth for the first quarter. Arithmetically, the acceleration compared with the first quarter is primarily attributable to the contribution from net trade, which no longer dampened GDP growth: exports of goods and services picked up more briskly than imports. In addition, private consumption expanded again more sharply. However, gross private fixed investment has increased only little lately. While real spending on residential construction continues to follow a clear upward trend, non-residential construction was somewhat curtailed. More sharply than their construction investment did companies restrain their equipment investment. All in all, the US economy returned to its moderate growth path in the spring, which according to the most recent extensive revision of the national accounts is somewhat flatter than assumed thus far. In July, the unemployment rate remained at its cyclical low (5.3 percent). Annual inflation as measured by the Consumer Price Index excluding energy and food stayed moderate in June (+1.8 percent).

3. Euro area: recovery proceeds

The crisis in Greece barely dampened the recovery in the euro area in the spring. According to the first official estimate, real GDP grew by ¼ percent on a seasonally adjusted basis in the second quarter, compared with the previous quarter, and by 1¼ percent compared with a year before. The statistical data available so far paint a predominantly positive economic picture both at the country and the sector as well as the expenditure component level. Only a few sectors experienced movements in opposite directions. Economic growth in Spain was again particularly brisk at +1 percent, quarter on quarter. In Germany, GDP rose by ½ percent, and in Italy by ¼ percent. France saw aggregate economic activity stagnate, following a marked increase in the first quarter. The majority of the other euro area economies expanded vigorously. In Finland (GDP –½ percent), the recession caused by the structural change in industry and the sharp decline in business with Russia has lasted for a year now. Greece's real GDP rose by ¾ percent in seasonally adjusted terms in the spring.

Leading indicators point to a positive outlook for economic activity in the euro area.

Leading economic indicators principally suggest that the recovery in the euro are will proceed in the summer months (June, July, August). In May, industrial new orders confirmed the increased level recorded in April, and on average over these two months exceeded the mean value for the first quarter. More recent sentiment indicators also suggest that the expansion will continue. Surveys by the European Commission also substantiate the robust assessment of the situation. In August, the European Commission's Economic Sentiment Indicator (ESI) improved slightly in the euro area and in the EU as a whole, thereby exceeding the long-term averages for both regions. In the euro area, it was dampened by a drop in the industrial confidence indicator, which was offset by a rise in the other business sectors (construction industry, services and, particularly, retail trade). A particularly marked rise in the ESI was registered in France and Spain, while it fell slightly in Germany and the Netherlands, and somewhat more sharply in Italy.

The slight improvement in the ESI in the EU is being driven by positive developments in Poland and the UK, the two largest economies of the EU outside the monetary union. On EU average, developments of the confidence indicators in all sectors of the economy have been broadly consistent with those in the euro area. Only the indicator for financial services confidence rose in the EU as a whole, while it remained flat in the euro area.

The Consumer Confidence Indicator improved slightly in the euro area in August compared with July, with consumers' more optimistic assessment of the future general economic situation being almost outweighed by their more pessimistic expectations regarding future unemployment. By contrast, private households' expectations of their future financial situation and savings remained broadly unchanged in August compared with July.

Long-term government bond yields remain low.

In the summer months (June, July and August), long-term government bond yields in the euro area countries remained, overall, broadly unchanged, standing at levels around 70 basis points higher than the lows recorded in mid-April. From the beginning of June until the end of August, interest rate developments in the individual countries were quite uneven: at first long-term AAA-rated government bond yields surged, possibly owing to slightly higher long-term inflation expectations. Deteriorating government bond market liquidity also appears to have driven yields up during that time. This was followed by a decline in average ten-year AAA-rated euro area government bond yields; at times they fluctuated more strongly, reflecting market participants' increased concerns about the Greek referendum. Yield spreads between Italian, Spanish and French government bonds and German federal bonds decreased, while the differentials of bonds of the remaining euro countries (except Greece) rose somewhat overall. Yields on shorter-term bonds continued to be negative in numerous euro countries, and even declined further in some cases, with the result that the yield curves remain steep.

Positive trends persist in euro area labour markets

The labour market situation continued to improve gradually in the spring, albeit somewhat less briskly. The unemployment rate dropped by 0.1 percentage point to 11.1 percent, seasonally adjusted, in the second quarter, compared with the previous quarter. In the first quarter, the decline in unemployment had been accompanied by a modest increase in employment.

4. Persistently weak investment determined economic developments in Austria in the first half of 2015

The Austrian economy remains sluggish and develops less favourably than the euro area average. Notably investment has been weighing on growth for more than a year now.

Austria's GDP rose by 0.3 percent, quarter on quarter, in the second quarter of 2015, somewhat more briskly than in the first quarter (+0.2 percent). In unadjusted terms, GDP exceeded the year-earlier level by 0.5 percent in the second quarter.

Domestic demand once again remained lacklustre in the second quarter. Personal consumption expenditure continued to post weak growth (+0.1 percent). Overall consumption also rose by 0.1 percent, although government consumption was only slightly more dynamic. The demand for equipment investment picked up for the first time since the second quarter of 2014 (+0.5 percent), providing a positive stimulus; companies increased their spending on both machinery and vehicles. The demand for construction investment, by contrast, has not increased for 1½ years. Overall investment in fixed assets was curtailed by 0.1 percent.

With economic activity picking up in the euro area, the Austrian export industry is also showing first signs of a rebound. The demand for exports increased by 0.2 percent, with the demand for goods rising again slightly (+0.1 percent) after declining in the two previous quarters. Net trade contributed positively to GDP growth amid stagnant import demand.

Developments of the economic sectors on the outlay side of GDP have been uneven. Manufacturing is only slowly gaining traction in Austria. After a phase of weakness in the second half of 2014, the pace of activity accelerated somewhat compared with the first quarter (+0.4 percent). In June 2015, the production index was 0.7 percent above the level recorded a month earlier (seasonally adjusted). Positive contributions to GDP growth came also from the services sectors. Value added increased by 0.4 percent each in the trade, transport, hotels and restaurants as well as in the real estate and housing sectors. By contrast, the decline in value added in the construction (–0.1 percent), credit and insurance (–0.5 percent) as well as information and communication (–0.7 percent) sectors had a dampening effect.

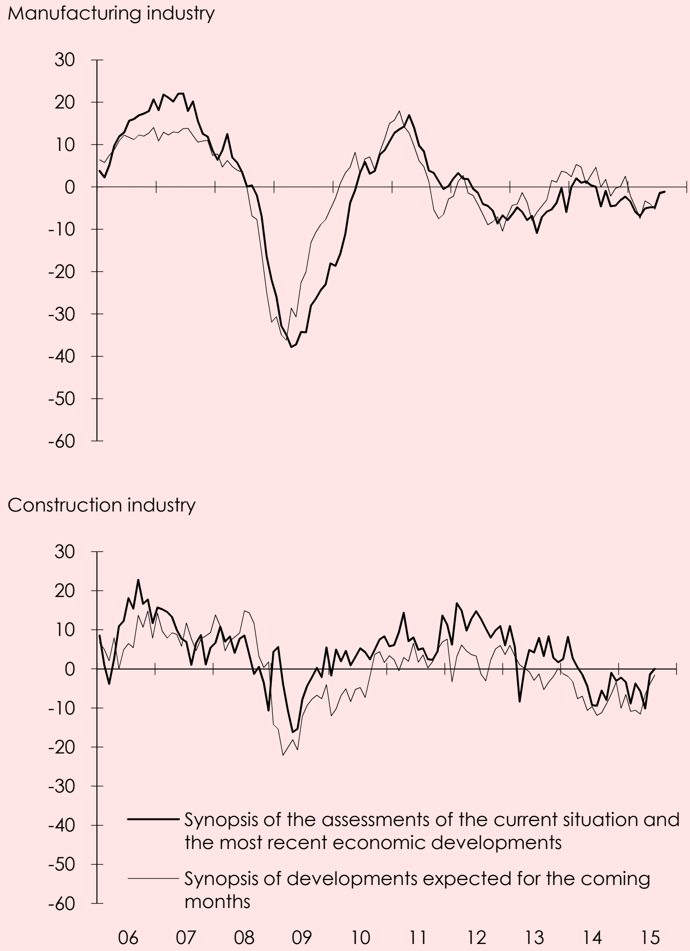
On the expenditure side, there was a shift in favour of wages and salaries. At +0.6 percent quarter on quarter in the second quarter, wages and salaries posted only slightly weaker growth than in the first quarter (+0.7 percent). Hence last year's pattern continued in the first half of the year. Conversely, companies recorded markedly lower rates of growth in operating surpluses and incomes of self-employed persons in the first half of the year (first quarter +0.2 percent, second quarter +0.4 percent, compared with the previous quarter). Hence the wage and salary ratio continues to rise.

The picture painted by leading indicators improved in August compared with the previous month.

In WIFO's Business Cycle Survey of August, Austrian companies still gave a slightly below-average assessment of the current situation. However, expectations for the next few months were somewhat more optimistic for the third consecutive time.

Figure 2: Results from the WIFO Business Cycle Survey

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



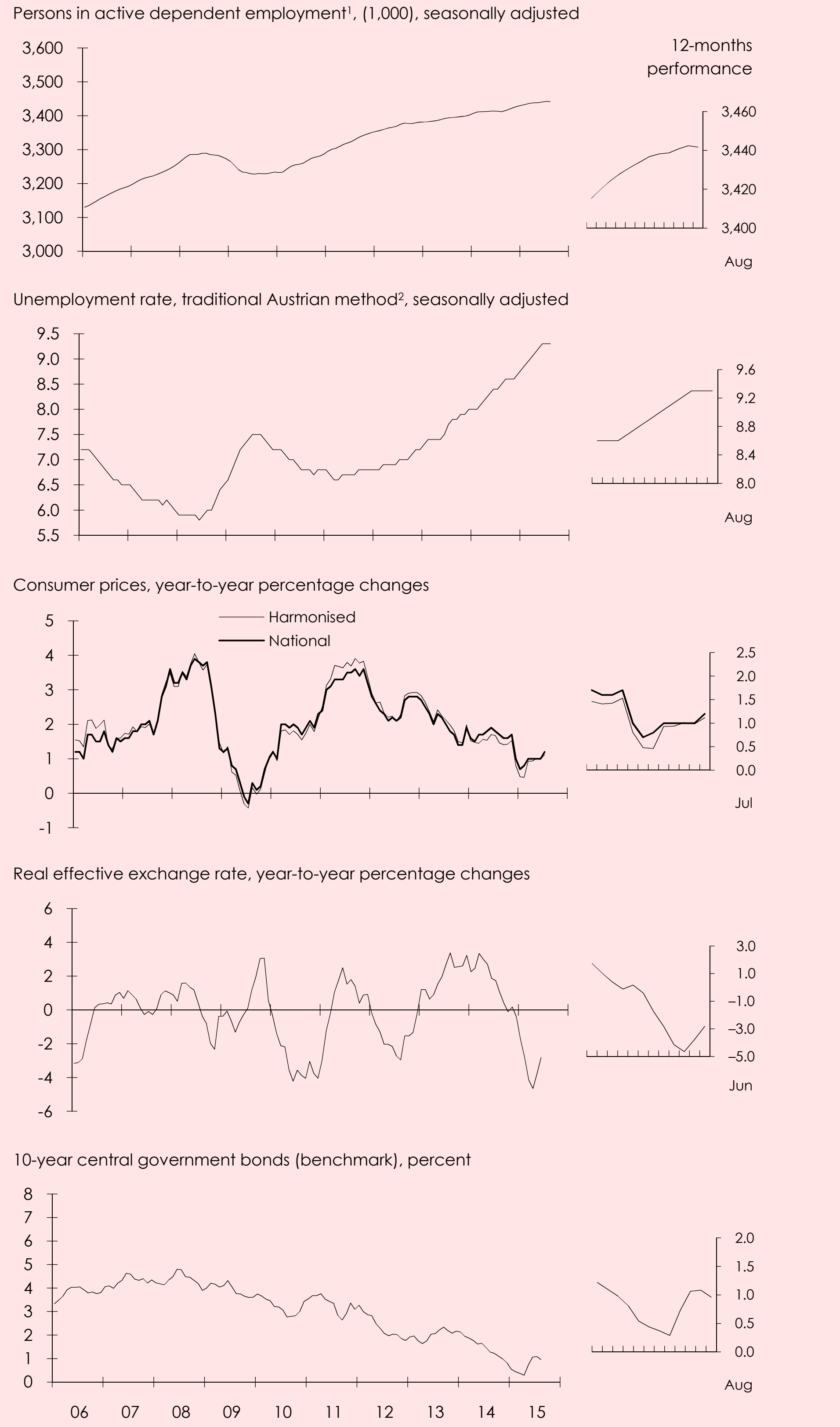
Source: WIFO Business Cycle Survey. Data refer to index points (percentage points) between +100 and –100. Values above 0 imply positive expectations, values below 0 indicate negative expectations.

In August, the present situation index for the economy as a whole came in higher than in July, entering positive territory for the first time since December 2014. Positive developments of the index have recently been registered also in manufacturing and construction, sectors of particular importance for the economy.

Economic expectations of the economy as a whole improved for the third consecutive month in August. Particularly firms in the services sectors have become more optimistic. A positive trend was also registered in construction and manufacturing, with the index just remaining in negative territory, though.

WIFO's Leading Indicator rose in August compared with the previous month. The upward movement seen in the spring thus continued, albeit at a slower pace recently. Developments of the sub-components were highly heterogeneous. Some domestic and foreign industrial indicators declined sharply in August. By contrast, domestic sub-indicators for construction and for the retail trade developed favourably.

Figure 3: Key economic indicators



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.

As a result of the most recent agreement with Greece on the third rescue package, stock market volatility had declined steadily also in Austria since the beginning of July. However, owing to the uncertainties spreading from the Chinese stock market in mid-August, ATX volatility briefly increased to just under 40 percent (annualised; measured by means of a GJR-GRACH model). This was the highest level of volatility measured since October 2011.

Volatility in China' stock markets has recently determined financial market developments in Austria.

The recent turbulence in stock markets barely influenced long-term government bond yields. Secondary market yields did rise briefly (August), but were thus in line with developments of those in Germany, with the result that the differential between Austrian and German secondary market yields remained unchanged. On the whole, however, Austrian secondary market yields have risen markedly since the beginning of May 2015. The interest rate differential vis-à-vis Germany has widened in accordance with this rise: between the beginning of 2015 and mid-June, the average differential between Austrian and German secondary market yields was approximately 0.1 percentage point; since then it has risen to 0.3 percentage point on average, and continues to follow a slightly upward trend. Apart from that, the level of secondary market yields on Austrian government bonds is still low compared with the long-term trend.

4.1 Inflation rose to 1.2 percent in July

Inflation stood at 1.2 percent in July 2015 (June 1.0 percent). Expenditure on services related to the provision of food and drink proved to be the main price booster, while the decline in fuel prices once again dampened inflation considerably.

Excluding the decline in fuel prices, annual inflation would have been 1.6 percent.

Particularly sharp year-on-year price increases were registered in the "Restaurants and Hotels" expenditure category (services related to the provision of food and drink +3.5 percent, accommodation services +0.2 percent). The increase in the "Housing, Water, Energy" expenditure category was mainly due to apartment rent increases (+4.8 percent). Apartment maintenance costs picked up by 1.3 percent on average compared with a year before (June 2015 +1.0 percent). As heating oil prices continued their downward trend (–19.3 percent), overall household energy prices declined again in July.

Inflation as measured by the Harmonised Consumer Price Index (compiled according to a methodology that has been harmonised across all EU countries) was 1.1 percent in July (June 1.0 percent), somewhat lower than CPI inflation, owing to a different weighting of components. The sharp decline in fuel prices markedly dampened the HICP compared with the CPI, as did above-average price increases for insurance services and apartment maintenance. By contrast, the price increase in the "Restaurants and Hotels" expenditure category raised the HICP compared with the CPI. Hence inflation in Austria markedly exceeded the euro area average (July 0.2 percent). The inflation differential between Austria and the euro area average has recently increased further owing to the fact that inflation has accelerated in Austria while it has again been receding slightly in the euro area as a whole, notably since May.

4.2 Labour market situation aggravated further

The number of persons employed continues to rise, despite weak economic growth. In August, just under 3.5 million persons were registered as being in dependent active employment, an increase by almost 1 percent from a year before. The labour force keeps growing owing to fewer people applying for early retirement, an increase in the labour force participation of women, and the brisk influx of labour from abroad. Given the weak economic growth, the number of additional jobs created remains insufficient, with unemployment therefore rising markedly. In August, just under 327,000 persons were registered as unemployed with the Public Employment Service, an increase by 35,000 or almost 12 percent compared with a year before. According to the national method of calculation, the unemployment rate reached 8.4 percent in August (July 2014: 8.1 percent). No substantial month-on-month change is apparent in seasonally adjusted terms; the rate was 9.3 percent in August. Although unemployment is rising continuously, the labour market is also sending positive signals: labour market tightness – a leading indicator for the labour market and

The unemployment rate continues to rise sharply in Austria. The labour force is increasing despite weak growth.

economic growth, measured by the unemployment and vacant jobs ratio (in both cases seasonally adjusted) – rose continuously from mid-2011 and in May 2015 reached a peak in the current cycle, but has been falling since then. Against this background, the outlook is positive for both the labour market and real economic growth.