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# Global Growth is Slowing

## Business Cycle Report of September 2011

**Global economic activity has been slowing in recent months. Economic growth in the USA and in Europe was subdued in the second quarter, and activity in Asia was also less buoyant. Against this background, concerns about the high levels of sovereign debt of some industrialised countries increased; this sparked financial market tensions.**

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The global economy has continued to lose momentum recently. In the USA, quarter-on-quarter economic growth remained subdued at 0.2 percent in the second quarter (first quarter +0.1 percent). This, in turn, delays the solution of structural problems: the unemployment rate stood unchanged at 9.1 percent in August, only 0.5 percentage point below the year-earlier level. Expectations concerning the development of economic activity in the USA in the second half of the year are muted also because of the high levels of private household debt and increased uncertainty surrounding the outlook for the country's finances.

The euro area economy likewise expanded at a quarter-on-quarter rate of only 0.2 percent in the second quarter (first quarter +0.8 percent). All the large economies virtually stagnated. The most recent survey evidence points to only sluggish growth also here in the second half of the year. After declining for several months, production expectations in industry deteriorated further in August. Consumer confidence has also weakened considerably recently, following the turmoil in the financial markets and increasing concerns regarding the state of government finance in some countries.

For the first time since the 2008-09 financial market crisis, Asia's emerging economies also saw economic activity weaken markedly: in the second quarter, quarter-on-quarter industrial production growth slowed to a mere 0.7 percent (first quarter +4.0 percent), while imports fell by 2.5 percent (first quarter +5.2 percent). However, this development is strongly influenced by the economic consequences of the environmental disasters in Japan; it remains to be seen whether or not a recovery will occur in the third quarter.

The more unfavourable economic outlook, the controversial debate about the government debt ceiling in the USA, and the debt crisis in the euro area created high uncertainty in financial markets in August. Following a severe decline – the Dow Jones Index fell by around 10 percent from the peak in July, the DAX by around 25 percent – stock prices stabilised for the time being towards the end of the month.

The brisk growth rate of the Austrian economy in the second quarter (+0.7 percent in real terms quarter-on-quarter) clearly stands out against the majority of countries in the euro area. The WIFO Business Cycle Survey indicates, however, that Austria's economy will very likely not be able to elude the cooling of global economic activity in the third quarter. While manufacturers have recently continued to give a positive assessment of current order books, leading indicators (production expectations, business situation in six months' time) have been declining markedly for several months now and in August were close to their long-time averages. Civil engineering

activity remains weak. Tourism sales from May to July were slightly below the year-earlier level.

Table 1: Quarterly national accounts

			2010				2011	
			First quarter	Second quarter	Third quarter	Fourth quarter	First quarter	Second quarter
			Percentage changes from previous quarter					
<i>Adjusted for seasonal and working day effects, volume</i>								
Final consumption expenditure			+ 0.9	- 0.3	+ 1.0	- 0.1	- 0.2	+ 0.5
Households <sup>1</sup>			+ 2.0	- 0.8	+ 1.7	- 0.4	- 0.4	+ 0.4
General government			- 0.0	- 0.3	- 0.0	- 0.2	+ 0.2	+ 0.4
Cross capital formation			- 2.6	+ 2.4	+ 3.9	+ 3.2	+ 2.6	+ 1.2
Gross fixed capital formation			+ 0.0	+ 0.6	+ 2.1	+ 1.8	+ 1.3	+ 0.9
Machinery and equipment			+ 2.2	+ 3.1	+ 4.2	+ 2.7	+ 1.8	+ 1.1
Construction			- 1.0	- 0.7	- 0.1	- 0.3	+ 0.3	+ 0.6
Exports, goods and services			+ 0.4	+ 5.6	+ 2.1	+ 0.7	+ 3.1	+ 0.1
Goods			- 0.1	+ 8.7	+ 3.7	- 0.4	+ 3.1	+ 0.5
Services			- 0.1	+ 1.4	+ 1.3	- 1.2	+ 1.0	- 0.5
Imports, goods and services			+ 0.8	+ 5.1	+ 3.2	- 0.3	+ 3.6	+ 0.3
Goods			- 0.0	+ 6.1	+ 3.5	- 0.1	+ 3.3	+ 0.6
Services			+ 1.4	+ 2.6	+ 2.1	+ 1.0	+ 2.3	+ 0.1
Gross domestic product			- 0.9	+ 1.4	+ 1.4	+ 0.6	+ 0.8	+ 0.7
Manufacturing			- 2.8	+ 7.4	+ 3.2	+ 1.8	+ 5.8	+ 0.9
	2009	2010			2010		2011	
			First quarter	Second quarter	Third quarter	Fourth quarter	First quarter	Second quarter
			Percentage changes from previous year					
<i>Volume, chained prices</i>								
Final consumption expenditure	- 0.1	+ 1.5	+ 3.2	- 0.1	+ 1.7	+ 1.5	- 0.3	+ 1.4
Households <sup>1</sup>	- 0.3	+ 2.2	+ 4.1	- 0.3	+ 2.6	+ 2.5	- 0.1	+ 1.7
General government	+ 0.2	- 0.2	+ 0.6	+ 0.7	- 0.9	- 1.2	- 0.7	+ 0.8
Cross capital formation	- 11.9	+ 3.6	- 10.1	+ 6.7	+ 8.8	+ 6.7	+ 24.7	+ 15.3
Gross fixed capital formation	- 8.3	+ 0.1	- 4.4	- 0.1	+ 0.1	+ 4.2	+ 3.1	+ 5.0
Machinery and equipment	- 9.7	+ 4.3	- 4.5	+ 3.4	+ 2.8	+ 15.2	+ 11.6	+ 9.9
Construction	- 7.6	- 2.9	- 4.9	- 1.8	- 2.1	- 3.0	- 1.5	+ 1.9
Exports, goods and services	- 14.3	+ 8.3	+ 1.5	+ 12.3	+ 11.1	+ 8.8	+ 12.2	+ 6.4
Goods	- 16.6	+ 10.9	+ 2.6	+ 15.3	+ 13.3	+ 12.2	+ 16.7	+ 8.1
Services	- 8.3	+ 2.2	- 0.8	+ 4.5	+ 5.8	+ 0.3	+ 3.3	+ 0.9
Imports, goods and services	- 13.8	+ 8.0	+ 1.9	+ 10.3	+ 10.8	+ 8.8	+ 13.4	+ 8.0
Goods	- 14.7	+ 9.1	+ 2.9	+ 12.1	+ 11.8	+ 9.7	+ 14.2	+ 8.7
Services	- 10.2	+ 3.7	- 1.7	+ 3.3	+ 7.0	+ 5.5	+ 9.6	+ 5.3
Gross domestic product	- 3.8	+ 2.3	+ 0.2	+ 2.6	+ 3.6	+ 2.6	+ 4.2	+ 3.4
Manufacturing	- 15.3	+ 7.4	- 1.8	+ 11.2	+ 10.4	+ 9.6	+ 19.3	+ 10.0
Gross domestic product, value	- 2.8	+ 4.1	+ 2.0	+ 4.2	+ 5.7	+ 4.5	+ 6.0	+ 5.6

Source: WIFO. – <sup>1</sup> Including private non-profit institutions serving households.

In July and August 2011, active employment stagnated on a seasonally adjusted month-on-month basis. The seasonally adjusted unemployment rate according to the Austrian method of calculation rose marginally to 6.8 percent in August. Vacancies have declined in recent months, while the number of unemployed persons has again risen slightly.

As economic activity slows down, the upward pressure on prices in commodity markets is easing. Still, the annual rate of inflation in the industrialised countries continues to be determined by the commodity price boom. In the euro area, inflation as measured by the harmonised index of consumer prices (HICP) reached 2.5 percent in July 2011. Inflation excluding energy and unprocessed food (core inflation) fell to 1.5 percent in July (June 1.8 percent). In Austria, HICP inflation stood at 3.8 percent in July (3.5 percent, as measured by the national CPI). HICP core inflation was 3.1 percent, exceeding the euro area average by 1.6 percentage points.

World trade lost considerable momentum in the second quarter. After quarter-on-quarter growth of 2.6 percent in the first quarter (according to Centraal Planbureau), the volume of world trade declined by 0.6 percent in the second quarter. Industrial production stagnated (-0.1 percent, after +1.9 percent in the first quarter).

**Global economic activity is weakening**

For the first time since the 2008-09 financial market crisis, the pace of economic activity in the emerging economies also slowed appreciably: in Asia's emerging economies, industrial production growth decelerated to a mere 0.7 percent (first quarter +4.0 percent), and imports fell by 2.5 percent (first quarter +5.2 percent). In Latin America, industrial production contracted by 0.3 percent, while imports rose by 4.1 percent (first quarter +1.6 percent and +3.1 percent respectively). However, the figures for the Asian region are largely influenced by the economic consequences of the environmental disasters in Japan. Having declined strongly in April, industrial production already began to rise again over the course of the second quarter, and another upward revision is expected in autumn.

In the USA, economic growth remained moderate in the second quarter (+0.2 percent, quarter-on-quarter; first quarter +0.1 percent). Developments in the critical areas have been muted: employment remained almost unchanged in the second quarter compared with the previous quarter and rose by only 0.2 percent on a year-on-year basis. In August, the unemployment rate stood at 9.1 percent, which was 0.5 percentage point lower than a year before, but actually 0.1 percentage point higher than at the beginning of 2011. The recovery in housing prices has also stalled again since the beginning of 2011, according to the Case-Shiller Index.

Given the persistent slack in these areas, expectations concerning the future development of the US economy are now clearly less optimistic than they were at the beginning of the year. The Manufacturing Purchasing Managers' Index (PMI) continued to fall in August and stood only marginally above its long-term average. Consumer confidence dropped to its lowest level since April 2009, according to the Conference Board Index. The Conference Board, in its August forecast for the second half of 2011 anticipated persistently moderate growth in 2011 and 2012, with annual growth rates of 1.6 percent and 1.8 percent respectively.

The euro area economy grew by 0.2 percent on a quarterly basis in the second quarter (first quarter +0.8 percent). All the large economies virtually stagnated: Germany (+0.1 percent), France ( $\pm 0.0$  percent) and the Netherlands (+0.1 percent) had still registered high growth rates clearly exceeding 0.5 percent in the first quarter. In Italy (+0.3 percent) and Spain (+0.2 percent), GDP expanded slightly, as in the first quarter. Industrial production in the euro area contracted by 0.7 percent month-on-month in June, after expanding by 0.2 percent each in April and May.

The most recent business cycle surveys suggest continuing subdued growth also for the euro area. After improving steadily since the second quarter of 2009, industrial confidence, the most important indicator of the EU Business Cycle Surveys, has been receding again since March 2011, mainly owing to the decline in the leading indicators new orders and production expectations. In August, the consumer confidence and retail trade confidence indicators also fell considerably amid the turmoil in the financial markets. The Ifo Business Climate Index also weakened markedly in August: firms still assessed their current situation positively; expectations regarding the business outlook were in line with the long-time average.

As economic activity slowed, the situation in the commodity markets eased somewhat: Brent crude oil prices stood at \$ 110 per barrel at the beginning of September; the HWWI index of commodity prices excluding energy retreated slightly from its peak level in April. Expressed in US dollars, it surpassed the year-earlier level by 19.2 percent in August (April 2011 +40.7 percent).

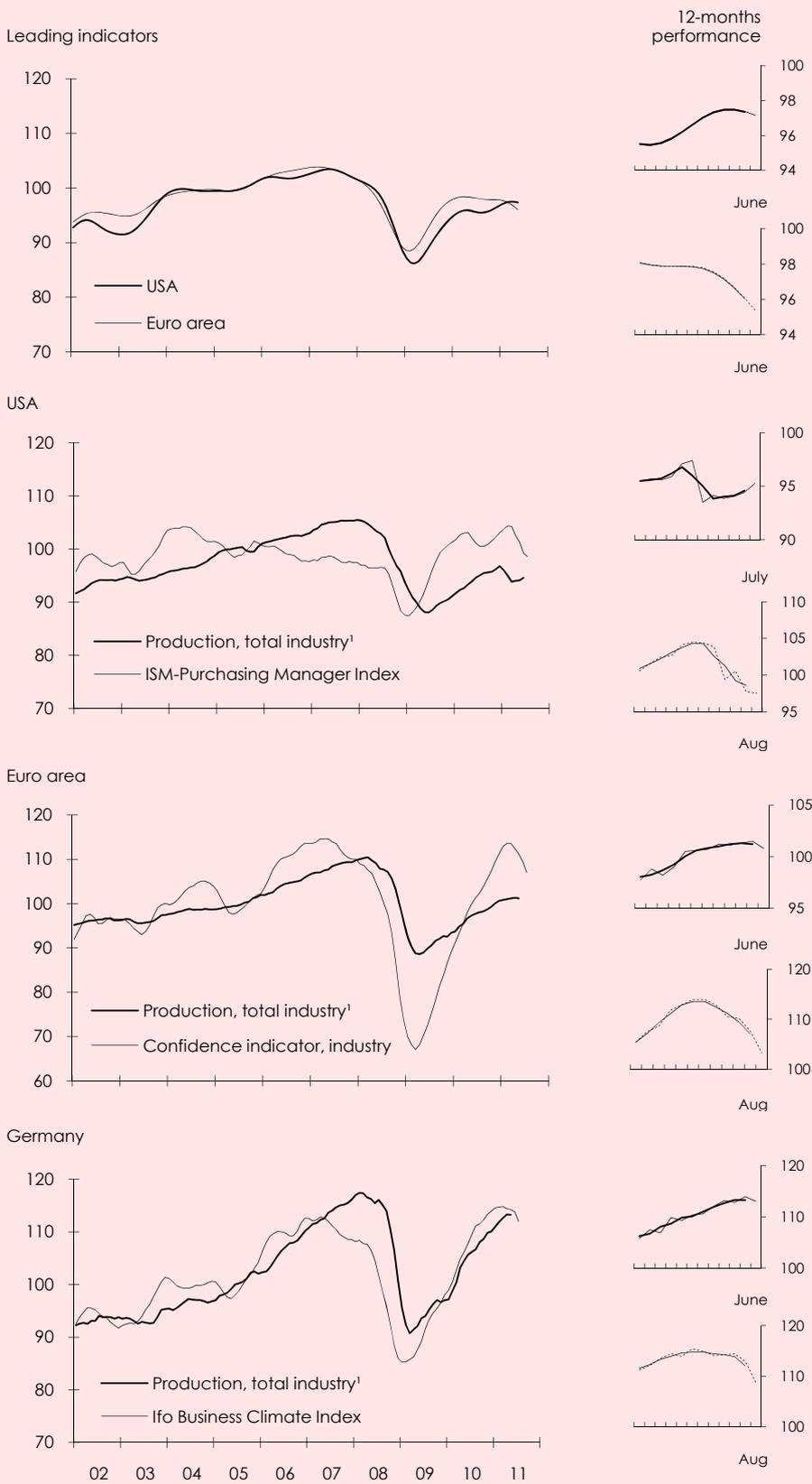
In July, CPI inflation in the USA stood at 3.6 percent, while HICP inflation in the euro area was 2.5 percent. The core inflation rate in the euro area fell to 1.5 percent in July (June 1.8 percent), reflecting, among other things, seasonal declines in the price of clothing and shoes (summer sale). The flash estimate for HICP inflation in August is 2.5 percent.

The slowdown in economic activity and the debate surrounding the state of government finance in the USA and in the euro area sparked severe turmoil in financial markets in August. Having declined substantially (Dow Jones Index by around -10 percent, DAX by around -25 percent, compared with their peak levels in July), stock prices stabilised towards the end of the month.

*The pace of global economic activity is now slowing, following the strong momentum seen until the beginning of 2011. This, together with the developments surrounding sovereign debt in the USA and the euro area, has recently exacerbated financial market tensions.*

Figure 1: International business climate

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



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

The brisk growth of the Austrian economy observed in the second quarter (+0.7 percent in real terms, compared with the previous quarter, according to the WIFO Flash Estimate) clearly stands out against the majority of countries in the euro area. Only four other euro countries recorded growth rates exceeding 0.5 percent. Compared with a year before, the increase in Austria was 3.4 percent in real terms (first quarter +4.2 percent).

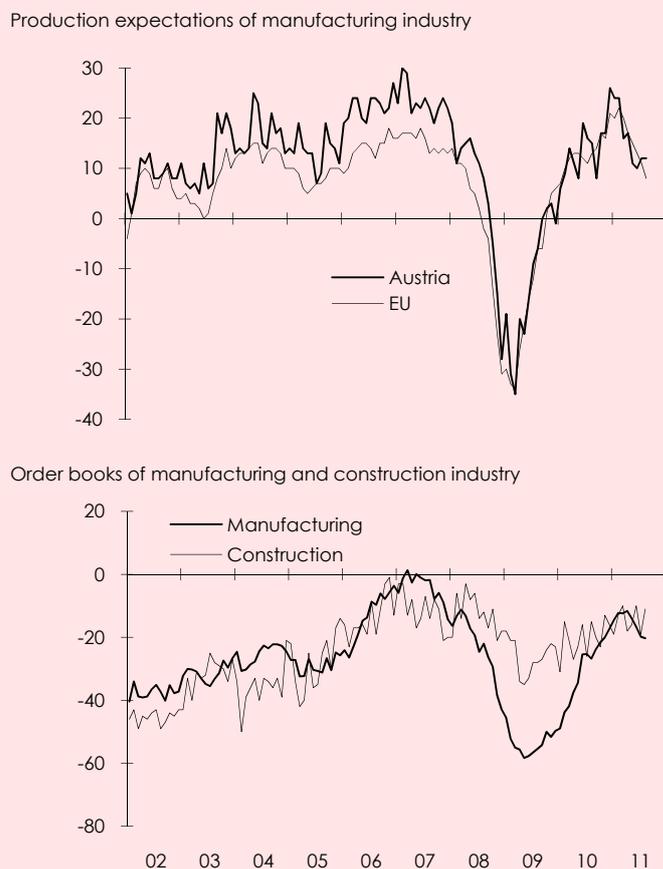
The strongest contribution came from foreign trade. While total real exports, at +0.1 percent quarter-on-quarter expanded at a clearly lower pace in the second quarter than recently (first quarter +3.1 percent), import growth lost slightly more momentum (second quarter +0.3 percent, after +4.6 percent). Business spending on machinery and equipment increased by 1.1 percent in the second quarter, less quickly than in the first quarter (+1.8 percent), while construction investment increased by 0.6 percent. Private consumption was quite robust, notwithstanding the drag on real incomes from the high inflation rate, and exceeded the level recorded in the previous quarter by 0.4 percent.

## Economic sentiment deteriorating in Austria

*Economic activity is likely to weaken also in Austria, the WIFO Business Cycle Survey suggests.*

Figure 2: WIFO Business Cycle Survey

*Differences between the percentage shares of correspondents giving positive and negative replies, seasonally adjusted*

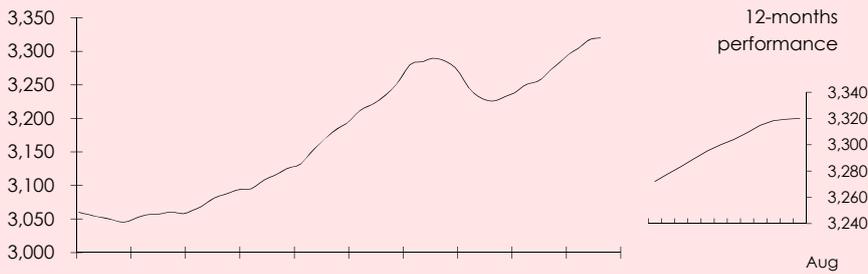


Source: European Commission, WIFO Business Cycle Survey.

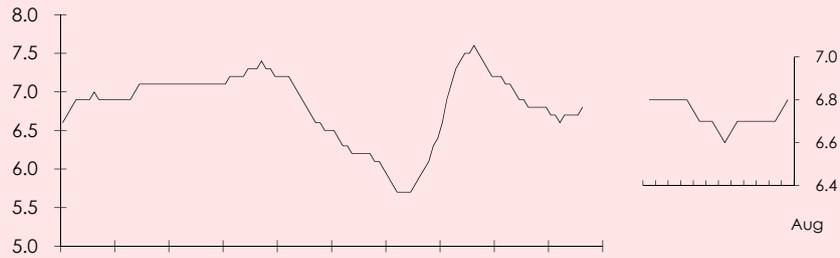
Evidence from the WIFO Business Cycle Survey shows, however, that the Austrian economy will very likely not be able to elude the cooling of global economic activity in the third quarter. It is true that production expectations are still positive, i.e., in the short term, more firms expect production to increase than to decline in the coming months. As regards the outlook for the business situation in six months' time, however, pessimistic expectations outweighed optimistic appraisals for the second consecutive time in August. The outlook darkened especially for manufacturers of capital goods and durable consumer goods. Positive expectations continue to be predominant only in the motor vehicle sector.

Figure 3: Key economic indicators

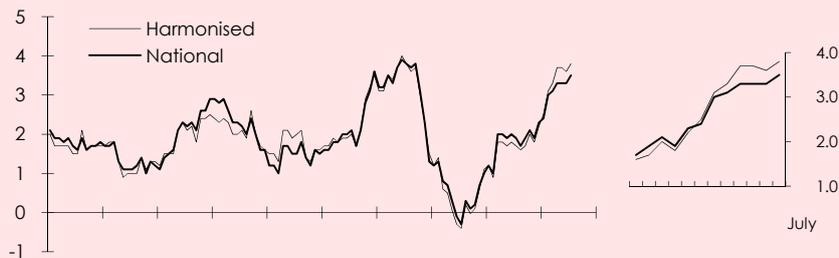
Persons in active dependent employment<sup>1</sup>, (1,000), seasonally adjusted



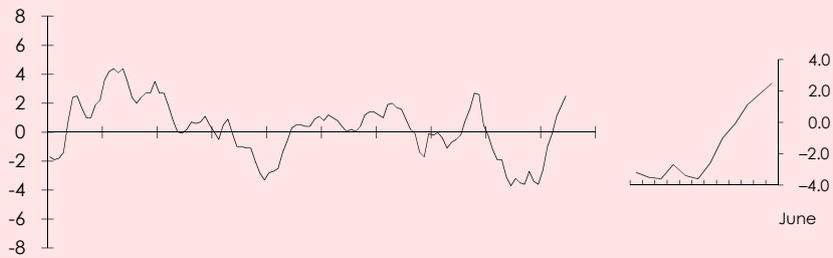
Unemployment rate, traditional Austrian method<sup>2</sup>, seasonally adjusted



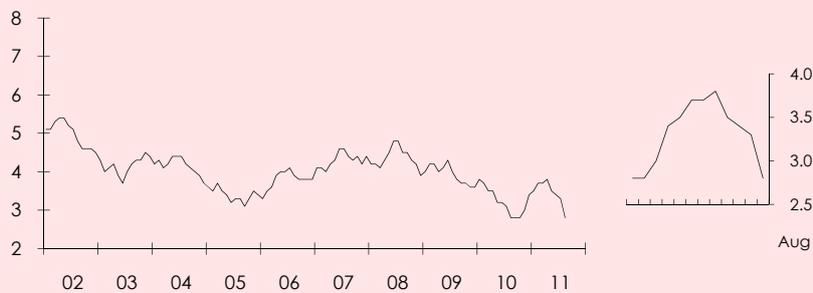
Consumer prices, year-to-year percentage changes



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".

The assessment of order books has deteriorated somewhat also in the construction sector, reaching a level again below the average for the last five years. Construction activity is likely to remain subdued in the coming months. Besides, only few firms still expect building prices to increase. The business services sector continues its recovery, albeit at a modest pace, with the assessment of order books again exceeding its long-run average in July. But the answers given in the WIFO Business Cycle Survey suggest that the upswing will slow down also here in the coming months.

In between May and July 2011, tourism firms recorded an increase in revenues to € 5.04 billion (+2.9 percent) compared to one year ago, according to provisional calculations. In real terms, however – i.e., after accounting for the annual price increase of 3.3 percent – sales declined by 0.4 percent. During this period, the number of nights spent rose by 1.7 percent. Hence, real expenditure per night spent – a quality indicator – declined by 2.1 percent.

In the first half of the 2011 summer season, the demand for overnight stays from foreign travellers surpassed the year-earlier level by 2.2 percent, while the nights spent by domestic travellers rose marginally by 0.6 percent.

Among the foreign source countries of importance for Austria, developments over this period were particularly satisfactory with respect to overnight stays by guests from Russia (+33.6 percent), Poland (+20.8 percent) and the Czech Republic (+16.5 percent). The demand from Italy (+2.5 percent) and Germany (+1.2 percent) also picked up somewhat compared with a year before, while the nights spent by travellers from Belgium (+0.5 percent), the Netherlands (–0.3 percent) and France (–0.4 percent) roughly stagnated. The demand from travellers from Denmark (–11.6 percent) and the UK (–11.4 percent), however, contracted considerably.

Tourism sales developments were roughly equal across all regions. Lower Austria posted the highest gains, while Vorarlberg, Carinthia and Tyrol recorded nominal growth rates below the Austrian average.

The first estimates for August 2011 show a weakening momentum in employment: the number of persons in dependent active employment did rise by 1.6 percent from a year earlier. However, the year-on-year comparison typically shows cyclical turning points with some lag compared with seasonally adjusted figures. On a seasonally adjusted basis, active employment remained unchanged from the previous month in July and August, according to advance estimates, interrupting the steady upward trend observed since September 2009.

Developments of job vacancies and of unemployment also suggest some loss of momentum in the labour market. The number of job vacancies has been falling recently: in seasonally adjusted terms, it dropped in July (–2.8 percent) and August (–4.8 percent) compared with the respective previous month. The year-on-year decline in August was 6.7 percent. The seasonally adjusted number of persons registered as unemployed has again been rising marginally since April, also owing to the decline in the number of training programmes offered by the AMS (Public Employment Service). In August, unemployment was up by 0.4 percent from a year earlier. However, the year-on-year comparison is distorted by the fact that since September 2010 persons able to work who receive subsistence payments have been classified as unemployed. The seasonally adjusted unemployment rate according to the Austrian method of calculation rose marginally to 6.8 percent in August.

In July 2011, consumer price inflation as measured by the national CPI was 3.5 percent in Austria. The upward drift in prices was for the most part due to price increases in the mineral oil products (+5.5 percent) and food (including non-alcoholic beverages, +4.4 percent) expenditure categories. These two sub-components, which represent only 17 percent of the consumption basket, accounted for 1.3 percentage points of overall inflation.

The harmonised inflation rate (HICP) was 3.8 percent in July, exceeding the euro area average (2.5 percent) by 1.3 percentage points. While core inflation (excluding energy and unprocessed food) picked up from 0.8 percent in April 2010 to 1.5 percent in the euro area, it rose much more strongly in Austria, from 1.0 percent to 3.1 percent. In July, this difference compared with the euro area continued to widen (to +1.6 percentage points). This deviation can be attributed primarily to the much higher than average services price inflation (Austria +3.7 percent, euro area +2.0 percent), which contributed 0.9 percentage point to the inflation differential. 0.4 percentage point of the inflation differential stemmed from the clothing and shoes sub-component (Austria +3.6 percent, euro area –2.6 percent).

## Stagnation of tourism

*In the three months to July, the tourism industry recorded a slight decline in price-adjusted sales compared with a year before.*

## Labour market weakening somewhat

*The seasonally adjusted number of persons in dependent active employment stagnated in July and August. The decline in the number of job vacancies points to some loss of momentum in the labour market.*

## Inflation rate still clearly above euro area average

*HICP inflation picked up slightly to 3.8 percent in July. The harmonised core inflation rate (excluding energy and unprocessed food) stood at 3.1 percent in Austria in July, 1.6 percentage points above the euro area average.*