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# Economic Conditions Remain Weak

## Business Cycle Report of December 2012

**Persistently weak demand in advanced economies increasingly dampens economic activity in emerging market economies. Contrary to preliminary calculations, Austrian GDP did not decline but rise slightly in the third quarter. While economic activity is set to remain subdued in the coming months, the general picture presented by indicators has not deteriorated further lately.**

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Weak demand in the euro area and in the USA continues to weigh on world trade, causing a noticeable decline in exports in emerging economies. In the USA, GDP figures for the third quarter were revised upwards, but this was mainly due to increased inventory accumulation and a pick-up in exports; growth in domestic demand turned out to be slower than originally expected. Japan's industry is affected to a particularly great extent by China's trade boycott, while the slowdown of growth experienced by China may have passed its nadir.

In the euro area, GDP contracted also in the third quarter. Economic output shrank persistently in the crisis countries Spain, Portugal, Italy and Cyprus, while Germany saw growth lose momentum. Among the EU countries outside the euro area, only the Baltic countries registered strong growth; in the UK, the Olympic Games had positive one-off effects in the third quarter. Unemployment continues to rise, reaching already very high levels in some countries. Refinancing conditions for countries remained stable in November.

Contrary to preliminary calculations, Austrian GDP increased slightly in the third quarter (+0.1 percent, compared with the previous quarter). Private consumption remained weak, investments declined. Exports did pick up, but the gain in value added was partly offset by an increase in imports. The growth in exports to Latin American and Asian emerging market economies observed at the beginning of the year has come to a standstill in recent months. Exports to Germany from January to September remained stable compared with the same period a year earlier, while those to Italy declined appreciably; deliveries to Switzerland, by contrast, continued to rise.

Following six months of decline, WIFO's new leading indicator for the first time pointed upwards in November; the Business Cycle Survey provides more unfavourable signals. Hence economic activity is set to remain subdued in the near future. Inflation remained above 2 percent in October. Unemployment was higher in November than a year before, with growth in labour supply outpacing growth in demand. Compared with a month before, notably seasonal effects were weighing on the labour market; the seasonal adjusted unemployment rate remained unchanged at 7.2 percent.

Demand in the advanced economies remains sluggish; import and industrial production growth is muted. World trade continues to lose momentum, with the three-month moving average seen declining for the second consecutive time in September compared with the previous period. Slack demand in the euro area and in the

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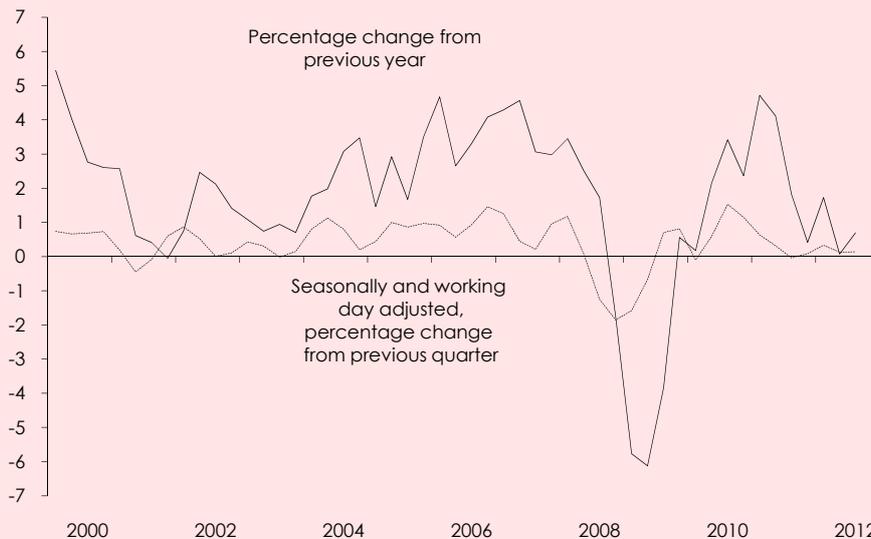
**Weak demand slows  
down world trade**

USA is causing a marked decline in exports in the emerging market economies of Asia, Latin America, Africa and the Middle East. Japan recently saw a particularly sharp fall in exports owing to China's trade boycott. US goods exports stagnated, while those of the euro area rose slightly.

Global industrial production has been more robust than trade of late: Growth did slow in the euro area and in the USA, but marked increases in the three-month moving average were observed in Asia and Latin America. While production picked up in most economic areas (up to +1.3 percent), it has been declining sharply for four months in Japan (September -4.1 percent); first signs of an improvement emerged in October.

*World trade continued to decline recently, reflecting weak demand in advanced economies. In the USA, domestic demand figures were revised downwards; Japan's economy suffers from shrinking exports; in China, the slowdown of growth may have passed its nadir.*

Figure 1: Growth of real GDP



Source: WIFO.

US GDP expanded more briskly in the third quarter than assumed in the preliminary calculation; the quarter-on-quarter growth rate was revised up from 0.5 percent to 0.7 percent. At the same time, however, private demand was lower than originally estimated: consumer spending once again grew at a below-average rate in the third quarter. The decline in equipment investment was higher than in the first estimate, and imports shrank. But these downward revisions were more than offset by an upward revision of exports (especially of services) and inventory accumulation.

Signs for a possible strengthening of private consumption in the months ahead are provided by confidence indicators, which have improved since the summer months. The Consumer Confidence Index rose to 73.7 points in November, after reaching an annual trough of 61.3 points in August 2012. The Consumer Sentiment Index stood at 82.7 points in November, up from its trough of 72.3 points in July. This development must be seen not least against a background of a renewed increase in house prices, which in the USA play an important role in lending policies. According to the Standard & Poor's Case Shiller Home Price Index, they rose for the eighth consecutive time in September, exceeding the year-earlier level by 3 percent.

Following stagnation in the second quarter compared with the first, Japan's economy shrank by 0.9 percent in the third quarter. While public demand still provided positive stimulus, private demand, especially fixed investment, declined. The negative trend is likely to continue also in the fourth quarter, goods exports plunged further in October (-2.8 percent, compared with the previous month); the diplomatic tensions with China also played a decisive role here.

## Demand in USA stagnating

## Decline in Japan, stabilisation in China

Table 1: Quarterly national accounts

			Second quarter	2011 Third quarter	Fourth quarter	First quarter	2012 Second quarter	Third quarter
<i>Adjusted for seasonal and working day effects, volume</i>								
Percentage changes from previous quarter								
Final consumption expenditure			+ 0.2	+ 0.2	+ 0.2	+ 0.1	+ 0.2	+ 0.2
Households <sup>1</sup>			+ 0.2	+ 0.1	+ 0.1	+ 0.0	+ 0.1	+ 0.0
General government			+ 0.5	+ 0.4	+ 0.0	+ 0.2	+ 0.4	+ 0.5
Cross capital formation			+ 1.2	+ 0.4	+ 0.2	- 0.0	- 0.7	- 0.8
Gross fixed capital formation			+ 1.6	+ 1.1	+ 0.6	+ 0.1	- 0.2	- 0.1
Machinery and equipment			+ 2.0	+ 1.3	+ 0.5	- 0.3	- 1.0	- 0.7
Construction			+ 1.4	+ 0.5	+ 0.3	+ 0.2	+ 0.2	+ 0.4
Exports, goods and services			+ 1.6	+ 0.3	- 0.0	+ 0.4	+ 0.6	+ 1.0
Goods			+ 1.9	+ 0.0	- 1.4	- 0.0	+ 0.5	+ 1.1
Services			+ 1.2	+ 1.2	+ 1.2	+ 1.1	+ 1.0	+ 1.0
Imports, goods and services			+ 1.4	+ 0.4	- 0.2	+ 0.0	+ 0.3	+ 0.8
Goods			+ 1.7	+ 0.6	- 0.6	- 0.7	+ 0.1	+ 1.0
Services			+ 0.8	+ 1.7	+ 2.7	+ 2.3	+ 1.4	+ 0.4
Gross domestic product			+ 0.3	- 0.0	+ 0.1	+ 0.3	+ 0.1	+ 0.1
Manufacturing			+ 0.8	- 0.1	+ 0.5	+ 1.2	+ 0.4	+ 0.5
	2010	2011	Second quarter	2011 Third quarter	Fourth quarter	First quarter	2012 Second quarter	Third quarter
<i>Volume, chained prices</i>								
Percentage changes from previous year								
Final consumption expenditure	+ 1.3	+ 0.5	+ 1.2	+ 1.0	- 0.0	+ 2.2	+ 0.0	+ 0.3
Households <sup>1</sup>	+ 1.7	+ 0.7	+ 1.8	+ 0.1	+ 0.5	+ 1.9	+ 0.1	+ 0.1
General government	+ 0.2	+ 0.1	- 0.3	+ 3.6	- 1.6	+ 3.0	- 0.1	+ 0.7
Cross capital formation	+ 3.8	+ 9.6	+ 9.6	+ 5.9	+ 2.9	+ 0.2	- 1.0	+ 3.5
Gross fixed capital formation	+ 0.8	+ 7.3	+ 7.9	+ 7.6	+ 5.1	+ 3.2	+ 0.4	- 0.2
Machinery and equipment	+ 6.0	+ 12.1	+ 13.4	+ 14.5	+ 4.6	+ 4.3	- 0.0	- 6.5
Construction	- 2.7	+ 4.4	+ 4.9	+ 3.5	+ 5.9	+ 2.0	+ 0.2	+ 3.6
Exports, goods and services	+ 8.7	+ 7.2	+ 7.2	+ 5.8	+ 3.7	+ 1.7	+ 0.9	+ 2.1
Goods	+ 11.4	+ 8.5	+ 8.0	+ 7.2	+ 2.0	+ 0.9	- 0.8	+ 1.1
Services	+ 2.4	+ 4.0	+ 4.9	+ 2.2	+ 8.2	+ 3.4	+ 6.3	+ 4.5
Imports, goods and services	+ 8.8	+ 7.2	+ 6.3	+ 5.8	+ 4.0	+ 2.0	+ 0.7	- 0.1
Goods	+ 9.4	+ 8.1	+ 7.2	+ 7.6	+ 3.2	+ 0.7	- 1.6	- 1.7
Services	+ 6.2	+ 3.6	+ 2.7	- 0.1	+ 7.3	+ 8.2	+ 10.5	+ 6.0
Gross domestic product	+ 2.1	+ 2.7	+ 4.1	+ 1.8	+ 0.4	+ 1.7	+ 0.1	+ 0.7
Manufacturing	+ 7.2	+ 8.5	+ 8.7	+ 7.1	+ 1.6	+ 3.6	+ 1.2	+ 2.8
Gross domestic product, value	+ 3.7	+ 5.0	+ 7.0	+ 4.0	+ 1.8	+ 3.6	+ 2.3	+ 3.2

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

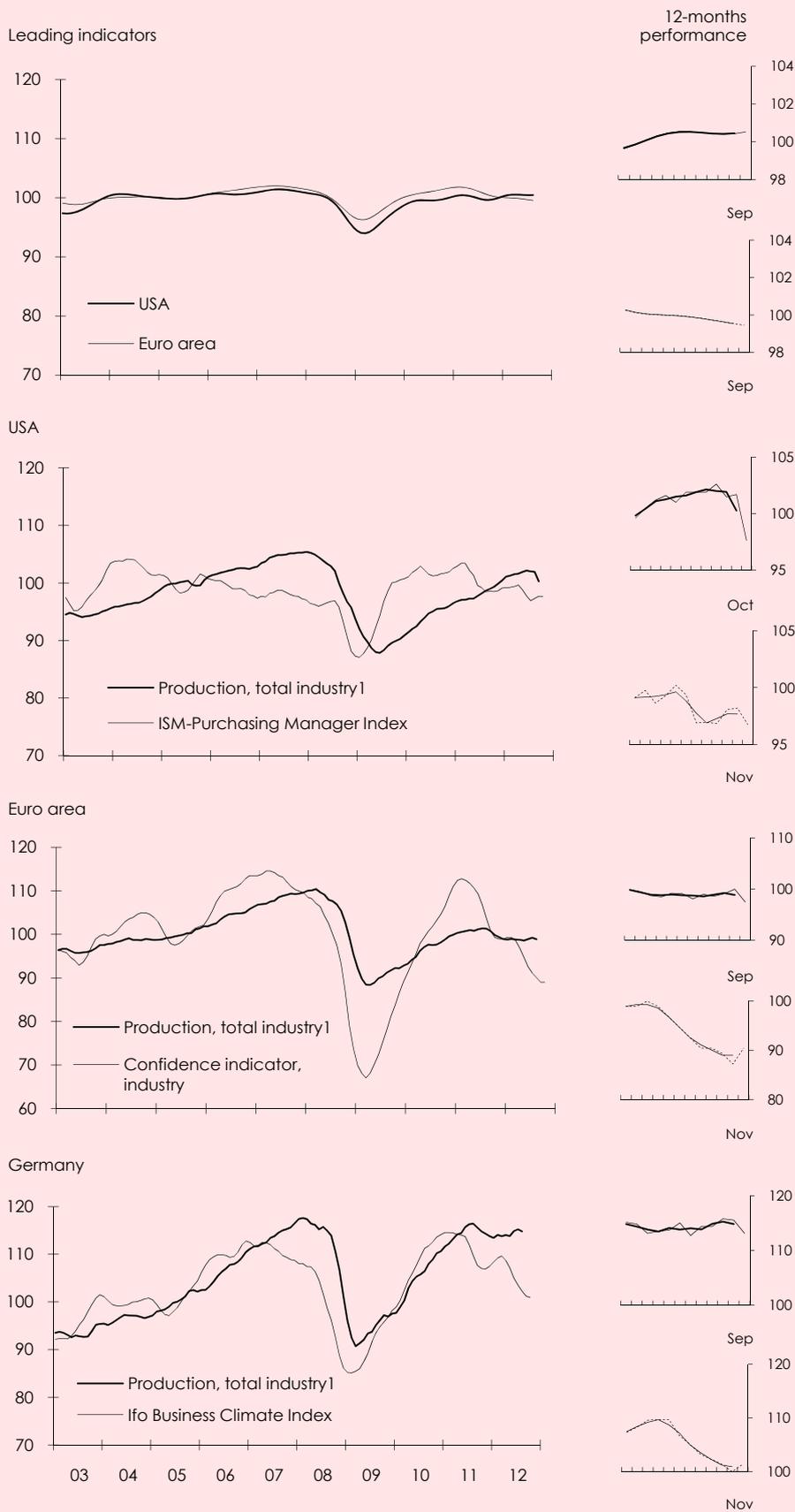
Meanwhile, there is increased evidence of stabilisation in China. The pace of growth decelerated markedly at the end of 2011 and the beginning of 2012 (fourth quarter 2011 +1.7 percent, compared with the previous quarter; first quarter 2012 +1.5 percent). In the second quarter, GDP grew by 2.0 percent, in the third quarter already by 2.2 percent. There is increased evidence that the slowdown in growth may have passed its nadir: Investment and industrial production picked up further in October; in the Purchasing Managers' Index survey, a slight majority of the persons surveyed gave a positive assessment of the outlook.

Since 1995, the GDP rates of change in the euro area and in the EU as a whole only once had different plus/minus signs (in the first quarter of 2003). In the third quarter of 2012, this parallel development was once again interrupted: in the euro area, GDP continued to decline in quarter-on-quarter terms (-0.1 percent), while in the EU as a whole it expanded by 0.1 percent. It would, however, be too soon to diagnose a basically divergent development, particularly as the increase on EU average was partly due to one-off effects of the Olympic Games in the UK (GDP in the UK in the third quarter +1.0 percent, quarter-on-quarter, following -0.4 percent on average from the fourth quarter of 2011 until the second quarter of 2012).

## Europe: poor economic performance

Figure 2: 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. - 1 Excluding construction.

There were further differences across the euro area: while economic output increased by 0.2 percent each in Germany and France, it continued to contract in the crisis countries Spain (-0.3 percent), Italy (-0.2 percent) and Portugal (-0.8 percent). However, the increases recorded in Germany were lower than those posted in the first and second quarters of 2012. The economic situation in France is also fragile, with the debate being determined by the declining competitiveness of the French industry. Continued robust increases were registered by the Baltic countries (Lithuania +1.3 percent, Estonia and Latvia +1.7 percent). The Netherlands suffered the biggest declines in the third quarter (-1.1 percent): investment was reduced considerably, and private consumption also contracted against the background of falling house prices.

The decline in confidence in the EU economies (Economic Sentiment Indicator) that had been observed since February came to a halt in November. Unemployment rates remained extremely high in October (euro area 11.7 percent, EU as a whole 10.7 percent). They continued to diverge significantly across the economic areas: The highest unemployment rates were recorded in Spain (26.2 percent; average 1990-2011: 14.8 percent) and Greece (August 2012: 25.4 percent, average 1990-2011: 10.5 percent), and the lowest in Austria (4.3 percent; average 1990-2011: 4.1 percent).

Long-term government bond yields remained stable in November: For 10-year bonds of Germany, the Netherlands, Finland and Austria, interest rates remained below 2 percent (as was also the case for bonds issued by the UK, the USA and Japan), for France and Belgium below 3 percent, for Ireland and Italy below 5 percent, for Spain and Slovenia below 6 percent. Interest rates were higher for 10-year bonds issued by Portugal, Greece and Cyprus, the latter being the fourth country in the euro area (following Greece, Ireland and Portugal) that is facing liquidity problems and is therefore likely to receive international financial assistance.

Commodity prices eased again slightly month-on-month in November. Overall, inflation in the euro area is likely to have declined to 2.2 percent in November, according to advance estimates (October 2.5 percent).

Contrary to provisional calculations, economic output increased slightly in quarter-on-quarter terms in the third quarter (+0.1 percent); private consumption, by contrast, remained persistently weak. Fixed investment, which had declined already in the second quarter (-0.7 percent), continued to fall also in the third quarter (-0.8 percent). Imports rose at a slower pace (+0.8 percent) than exports (+1.0 percent), with net exports consequently contributing positively to growth. Government consumption continued to expand compared with the previous quarter (+0.5 percent).

On the production side, an increase was recorded in the third quarter – as had been the case already in the preceding quarters – in goods production, as well as in the construction and the real estate and housing sectors. Value added declined considerably in trade and in the information and communications sector, while the credit and insurance industry also continued to contribute negatively to value added. The agriculture and forestry sector posted its first gain in 12 months. Against this background, the employment situation in the individual sectors highlights divergent productivity developments: the ongoing decline in employment in agriculture and forestry points to an increase in productivity, while productivity decreased amid rising employment in the credit and insurance sector as well as in the information and communications sector.

From January to September 2012, Austria recorded a trade deficit of € 5.6 billion (cumulated), a decline by € 1.0 billion compared with a year before. Over this period, exports rose by 1.6 percent (exports to EU countries -0.7 percent), imports by 0.4 percent. Among the key target markets of Austria's export industry, the strongest decline in goods exports so far this year has been registered for Italy (January to September -8.3 percent). Developments are expected to remain subdued over the

*GDP contracted slightly in the euro area in the third quarter; the small increase on EU average overall was partly driven by one-off effects in the UK. Unemployment is rising at high levels. Refinancing conditions of the euro countries remain stable.*

### **Austria: small third quarter expansion of GDP**

*While domestic demand remained persistently weak, exports rose once again; however, rising imports partly offset the growth in value added achieved. A decline in key export markets was compensated for by an increase in exports to emerging market economies.*

### **Increased exports to emerging market economies**

short term: Italian GDP is shrinking, with private demand being held back not least by the restrictive fiscal policy. Developments of goods exports to Germany, Austria's biggest export market, have been similar so far this year to those of last year. Economic conditions in Germany are deteriorating, however: according to IMK, a recession is becoming ever more likely; the DIW Economic Barometer shows stagnation for the fourth quarter, compared with the previous quarter, and thus a marked cooling of the economy. However, the ifo Business Climate Index rose for the first time in November after six months of decline. Exports to Switzerland continued to increase vigorously also this year (+6.2 percent). But economic activity is likely to lose momentum, given that the KOF Economic Barometer fell for the second consecutive time in November.

Developments of foreign trade with East European countries have also been highly uneven so far this year: while goods exports to Poland until September rose by 2.2 percent compared with the same period a year before, exports to the Czech Republic (-6.6 percent) and Hungary (-3.0 percent) declined. Both countries have been in recession since the beginning of the year. By contrast, exports to countries outside the EU, notably to emerging market economies of Latin America (+27.6 percent) and Southeast Asia (+16.9 percent), grew briskly. Exports by Austrian companies to the USA until September increased by 10.6 percent, year-on-year, those to China by 4.9 percent.

However, exports to EU countries again picked up slightly in seasonally adjusted terms in July and August, compared with the previous period, and companies were also able to slightly increase their exports to Italy in August. The gains in Latin America were already achieved at the beginning of the year, as the month-on-month comparison shows, whereas from May to August exports to these countries stagnated or even declined somewhat. Exports to China, by contrast, have again picked up recently; those to emerging market economies in Southeast Asia and to the USA have risen steadily.

Consumer confidence deteriorated steadily from mid-year onwards; however, the confidence index for October for the first time showed a slight month-on-month improvement. Private households continue to be cautious in their spending on consumer goods (new car purchases, for instance) – experience shows that this kind of expenditure reacts in a highly sensitive and pro-cyclical manner to the business cycle. In October, the number of new car registrations for private households again remained far below the year-earlier level (-9.1 percent, cumulated from January to October). Following a sharp decline in September, retail sales (excluding motor vehicle sales) stagnated in October, according to provisional calculations.

WIFO's new leading indicator is a combined monthly indicator, which shows economic turning points of the Austrian economy ahead of time. In November, the indicator rose for the first time after sliding steadily downwards in the preceding months; hence an improvement of economic conditions in the first half of 2013 has become more likely. Among the individual indicators, only the number of vacant jobs and production expectations continued to decline. The other indicators for Austria as well as the indicators for Germany and for the euro area improved slightly in November compared with the previous month.

WIFO's Business Cycle Survey of November presents a more unfavourable picture than the WIFO leading indicator: while the assessment of the current situation stabilised in manufacturing, the Business Expectations Index continued its downward trend. Companies expect selling prices to increase slightly and employment to decline in the months ahead. The assessment of the current situation improved especially among manufacturers of consumer goods. The guarded optimism shown by construction firms remains unbroken and has now also spread to the assessment of the employment situation in the sector. Companies in the hotel and restaurant industry are also predominantly optimistic for the winter season.

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### Private consumption muted

*Private consumption remains persistently weak. The downward slide of WIFO's leading indicator has recently come to a standstill..*

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### WIFO's leading indicator: downward slide stopped

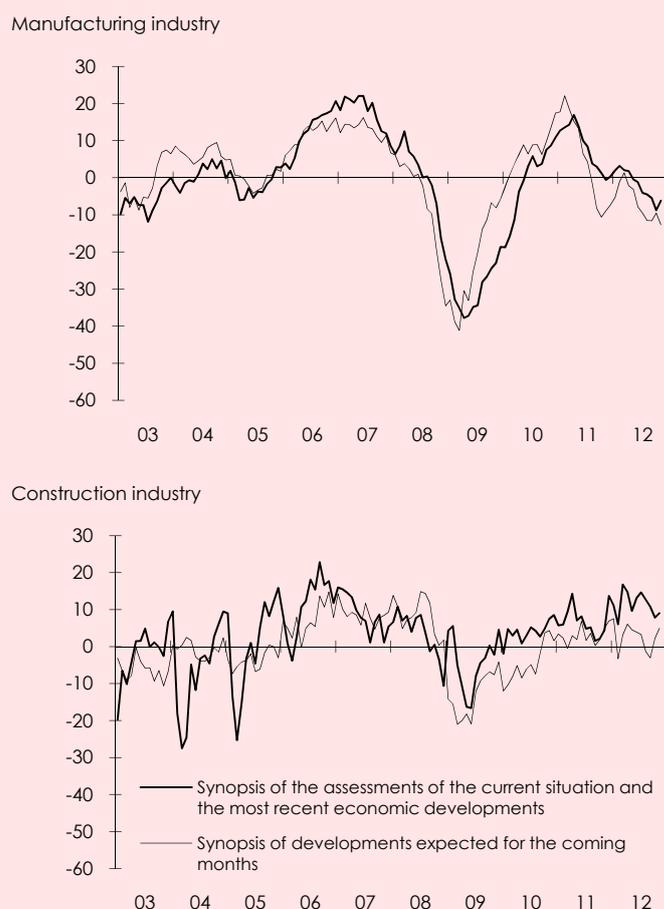
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### WIFO Business Cycle Survey: current situation improved, lending more restrictive

In November, just under one third of the companies (32 percent) surveyed in WIFO's quarterly credit demand survey felt banks' current lending policies to be restrictive; among the companies with a concrete demand for credit (about one fourth of all companies), this share amounted to just under half (49 percent). The share of those companies to which a loan had been extended of the expected amount and on the expected terms fell to 42 percent from 55 percent in November of last year. While the probability of receiving a loan rises with the size of the company, firms in manufacturing were most frequently granted the desired loan, followed by companies in the services and the construction sectors.

Figure 3: Results from the WIFO Business Cycle Survey

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



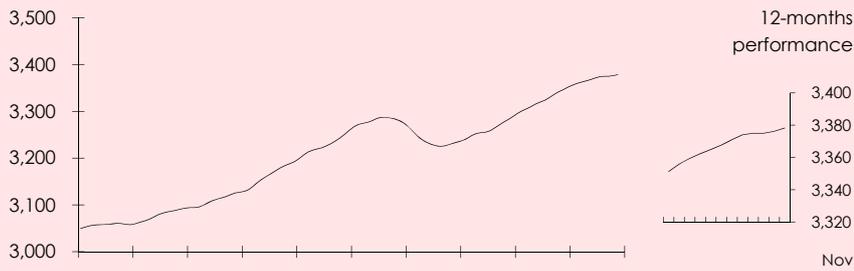
Source: WIFO Business Cycle Survey. Data refer to index points (percentage points) between +100 and -100. Values above 0 imply positive expectations, values below 0 indicate negative expectations.

Following its surge to 2.7 percent in September, inflation rose again in October (2.8 percent); compared with the previous month, upward price pressures increased by 0.2 percent. Price developments for those product groups that determined year-on-year inflation dynamics (energy, housing, transport and food) were uneven on a month-on-month basis: food prices continued to rise at an above-average pace. Month-on-month price increases for housing, water and energy were in line with the average increases registered in recent months. The contributions of the product groups clothing and shoes to inflation were weaker in October than in September. Fuel prices and the cost of motor vehicle use and maintenance declined compared with the previous month. The price of purchases made daily went up by 3.5 percent year-on-year in October, while that of purchases made weekly increased by 4.0 percent.

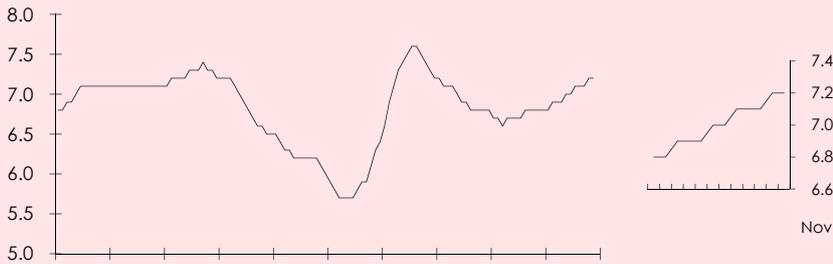
**Inflation remains above 2 percent**

Figure 4: Key economic indicators

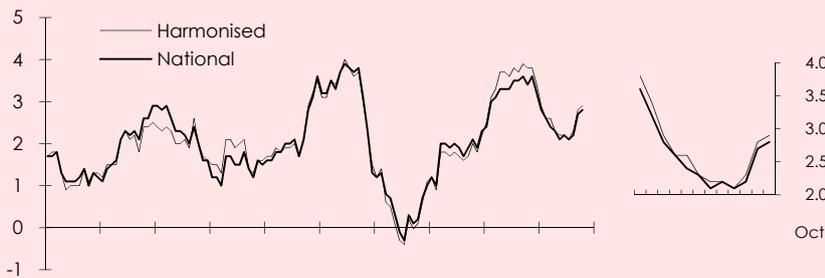
Persons in active dependent employment<sup>1</sup>, (1,000), seasonally adjusted



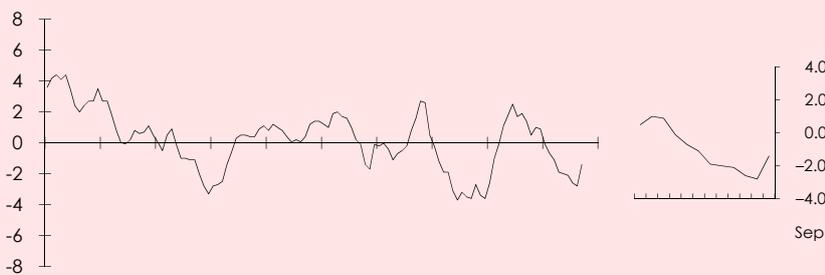
Unemployment rate, traditional Austrian method<sup>2</sup>, seasonally adjusted



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.

### Average rates of change

The time given refers to the initial and the final value of the period of computation: hence the average rate 2005-2010 comprises as the first rate of change that from 2005 to 2006, and as the last that from 2009 to 2010.

### 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.konjunkturtest.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 with a valid employment contract. By deducting their number one arrives at the number of "persons in dependent active employment".

The number of persons unemployed rose by 17,014 in November compared with a year before (+6.7 percent); besides, more unemployed people were enrolled in vocational training programmes. Overall, 344,521 people were without a job, an increase by 23,148 from a year before. The simultaneous increase in employment signals a persistent expansion of the labour supply in Austria. However, supply growth outpaced demand growth over the course of the year, as is shown by the year-on-year increase in the unemployment rate. Compared with the previous month, notably seasonal factors are weighing on the labour market: while the unadjusted unemployment rate increased from 6.7 percent in October to 7.2 percent in November, the seasonally adjusted unemployment rate remained unchanged at 7.2 percent.

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### **Persistent increase of labour supply**