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Buoyant Economic Activity in First Half of the Year

Business Cycle Report of February 2018

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Economic activity is currently buoyant globally as well as in Austria and is expected to maintain its momentum also in the first few months of 2018. The Austrian labour market continues to recover, although unemployment remains high. The inflation differential vis-à-vis the euro area average persists.

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The global economy continues to grow briskly and is likely to maintain its momentum also in the coming months. Recently the pace of expansion has slowed somewhat in the USA; however, at +0.6 percent, quarter on quarter, GDP continued to grow markedly in the fourth quarter. So far, there have been hardly any signs that economic activity in the USA may be slowing: industrial production increased in December, and continued positive consumer sentiment suggests that consumer demand will remain lively in the coming months.

This is also supported by the favourable labour market situation in the USA. The unemployment rate was 4.1 percent in January, the lowest rate recorded in 15 years. However, the pace of its decline has slowed considerably of late, despite further employment gains. The low labour force participation rate and only slowly rising wage pressures until now indicate that there is still spare capacity in the US labour market.

In the euro area, the economic upswing is broad-based across regions and demand components. GDP rose by 0.6 percent on a seasonally adjusted quarter-on-quarter basis in the fourth quarter. Germany, France and Spain and many smaller countries of the euro area registered brisk economic growth. Firms and private households also continue to assess the present situation and future developments positively. Therefore economic activity is expected to remain buoyant in the coming months. Labour markets also continue to improve. The unemployment rate declined to 8.7 percent in the euro area in December, the lowest level in eight years. Nevertheless, in many countries unemployment is still markedly higher than it was before the financial and economic crisis, and inflation has so far remained subdued (HICP +1.3 percent in January, according to provisional estimates).

The Austrian economy also continues to grow vigorously. In the fourth quarter of 2017, GDP increased by 0.8 percent, quarter on quarter, according to WIFO's Flash

Estimate. The expansion continues to enjoy broad support from all demand components. This benefits especially the manufacturing sector. The Austrian economy is expected to maintain this momentum also in the coming months. Managers' assessments of their present and future business situation continue to be extremely positive. But while sentiment has recently deteriorated slightly in the manufacturing and construction sectors, it has improved further in services. Consumer sentiment is also optimistic.

Austrian labour market conditions are also improving further, owing to the robust performance of the economy. Employment continued to rise in January, and unemployment declined. However, the seasonally adjusted unemployment rate was still very high at 7.9 percent according to the national definition.

Inflation (CPI), at +2.2 percent (HICP +2.3 percent), was considerably higher than the euro area average in December. The upward drift in prices was due mostly to price increases in the "housing, water, energy", "food and non-alcoholic beverages", "transport", "recreation and culture" as well as "restaurants and hotels" expenditure categories. The core inflation rate (HICP) was +2.3 percent in December.

1. US economy maintains strong momentum

US GDP, at +0.6 percent quarter on quarter, continued to grow at a brisk pace in the fourth quarter of 2017. The expansion of demand was supported by a marked increase in personal consumer spending, investment and exports. The growth momentum weakened slightly compared with the previous quarter, however. This was due to stock reductions, after an accumulation of stocks had sustained demand in the third quarter.

Economic indicators, though not improving further recently, continue to point to sustained positive momentum in the USA. Having increased slightly in December, the ISM Purchasing Managers' Index moderated again somewhat in January. Consumer sentiment according to the Conference Board and the University of Michigan's Consumer Sentiment Indicator also deteriorated slightly in January. But all indicators have maintained very high levels. The expansion of industrial production in December also suggests that economic activity will remain buoyant.

Labour market conditions have improved significantly in recent years owing to the robust performance of the economy. The unemployment rate was 4.1 percent in January, the lowest rate recorded in more than 15 years, and long-term unemployment as well as the number of involuntary part-time workers were also considerably lower compared with a year before. However, the unemployment rate has been unchanged since October 2017, and the labour force participation rate has also barely changed in the last twelve months, although considerable employment gains have been registered over this period. Apparently the additional demand for labour is being met by the increase in the labour force, while the unemployment rate has bottomed out. The fact that there is no marked acceleration in wage growth and the subdued inflation momentum also suggest that there is still spare capacity in the labour market.

So far there has been little indication that economic activity in the USA may be slowing. GDP is growing vigorously, and economic indicators are persistently positive.

2. Stock prices extremely high

Price developments in stock markets remain remarkable. At the end of January, the S&P 500 Stock Index for the USA was around 80 percent above the level seen in 2007. Since the presidential election in November 2016 it had risen by more than 30 percent. In January 2018 alone, it rose by around 6 percent, but dropped slightly at the end of the month and markedly at the beginning of February. While these developments are assumed to partly reflect higher profit expectations on account of the planned corporate tax cut, they also show fears of a quicker increase in key interest rates in the USA. A further sizeable price correction cannot be ruled out. Real estate prices have also been rising again considerably since their trough in 2011, according to the S&P/Case-Shiller Index, and have almost doubled since 2000. In

Stock prices have picked up sharply in the USA in recent months. Following the stock losses at the beginning of February, the risk of further price corrections remains high.

addition, the personal savings rate dropped to a similarly low level in the fourth quarter as last recorded in 2006. However, unlike before the financial crisis, the ratio of household debt to disposable income has barely increased in recent years.

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.

3. Euro area economy growing markedly

The euro area economy expanded again relatively briskly at the end of 2017. GDP increased at a seasonally adjusted quarter-on-quarter rate of 0.6 percent in the fourth quarter, according to provisional estimates. Economic activity was robust in all large euro area countries. The French economy grew by 0.6 percent in the fourth quarter compared to the previous quarter, while Spain recorded growth of 0.7 percent. German GDP also picked up noticeably in the fourth quarter; in aggregate terms, output increased by 2.2 percent, year on year, in 2017.

Assessments of the present situation and the outlook for the coming months are also very positive, according to the European Commission's business survey. The Economic Sentiment Indicator (ESI) did decline slightly in January, albeit after previously climbing to an extremely high level in December. Assessments by enterprises in industry of capacity utilisation, order book levels and production expectations are extremely positive; consumer confidence has also improved considerably lately. The breadth of the upswing is reflected in business surveys; sentiment is positive in all countries of the euro area.

The steady improvement of labour market conditions also contributes to this development. In December, the unemployment rate came in at 8.7 percent, the lowest rate recorded in eight years. However, it still remained 1½ percentage points above the level recorded prior to the economic crisis. Since January 2017, the unemployment rate has dropped by 1 percentage point. If it keeps falling at this pace, the unemployment rate is expected to reach its pre-crisis level in the course of 2019. Although unemployment is declining in all countries of the euro area, it is still very high in some and further away from pre-crisis levels than on euro area average.

Inflation in the euro area remains subdued. In January, the Harmonised Index of Consumer Prices (HICP) was up by 1.3 percent compared with a year before, according to provisional estimates. Core inflation (HICP excluding energy and unprocessed food) was even lower at +1.2 percent and unchanged from previous months.

The broad-based economic growth in the euro area is set to continue in the coming months. Sentiment is positive, and unemployment is declining. Inflation remains extremely subdued.

4. Austrian economy posted vigorous growth in fourth quarter of 2017

Economic activity in Austria remained robust at the end of 2017. In the fourth quarter of 2017, GDP rose by 0.8 percent, quarter on quarter (trend-cycle component), according to advance estimates (third quarter +0.9 percent, second quarter +0.8 percent). Aggregate output for 2017 exceeded the year-earlier level by 2.9 percent. The expansion momentum is unbroken, especially in manufacturing: in the fourth quarter, value added in this sector increased by 2.9 percent compared with the previous quarter. But value added also rose markedly in construction and in several services industries, while its momentum weakened noticeably in the trade sector at the end of 2017.

The expansion was supported by the continuous growth of private consumption and a persistently strong investment momentum. In particular machinery and equipment investment continued to rise vigorously in the second half of 2017; construction investment growth, by contrast, lost considerable traction. However, a substantial accumulation of inventories has been registered in the last three quarters, supporting demand so far. A reduction of these stocks may contribute to a slight weakening of economic activity in the coming months. Exports, notably goods exports, also grew sharply in the fourth quarter, clearly reflecting the robust growth of global activity.

Austria's cumulative nominal exports from January to November 2017 rose by 8.6 percent compared with the same period a year before. The breadth of the global economic upswing is apparent in a sharp increase in Austrian exports to almost all important trading partner countries. Only exports to Switzerland and the UK declined compared with a year before.

Austrian GDP continued to increase vigorously in the fourth quarter. Economic growth for 2017 was just under 3 percent.

4.1 Favourable outlook for economic activity in first half of 2018

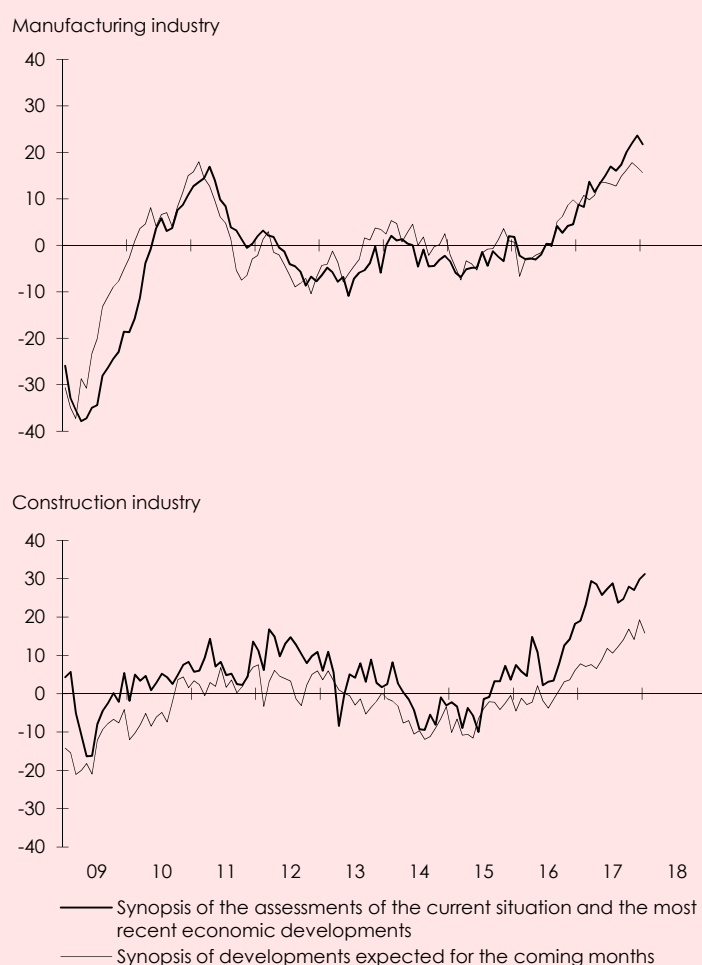
The Austrian economy is set to expand sharply also in the first few months of 2018. According to the WIFO-Konjunkturtest (business cycle survey), companies' assessments of both their present situation and developments in the coming months continue to be extremely optimistic. The Present Situation Index rose further on a seasonally adjusted month-on-month basis in January, reaching a new peak. Assessments improved in particular in the construction and services sectors. In manufacturing, by contrast, the Present Situation Index fell slightly for the first time since summer 2017. It had, however, climbed to an extremely high level until December; hence sentiment in manufacturing also continues to be very positive. The slight deterioration in assessments concerned above all the production of primary products and consumer goods, while sentiment in the capital goods industry improved further.

Companies also continue to be upbeat about their future business situation. The respective index did moderate marginally in January according to WIFO-Konjunkturtest, but stayed within the range of its record highs. This also reflected the somewhat more pessimistic assessment by firms in manufacturing originating from the primary products and consumer goods industries. By contrast, the index improved again markedly in the capital goods industry. Expectations were slightly better in January than they had been in the preceding months in the services sector, while they deteriorated considerably from an extremely optimistic level in construction.

Austrian companies' assessments of their present situation and developments in the coming months remain extremely positive.

Figure 2: Results from the WIFO-Konjunkturtest

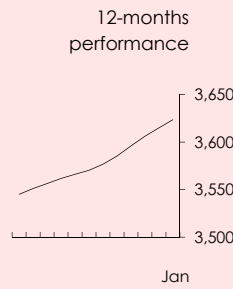
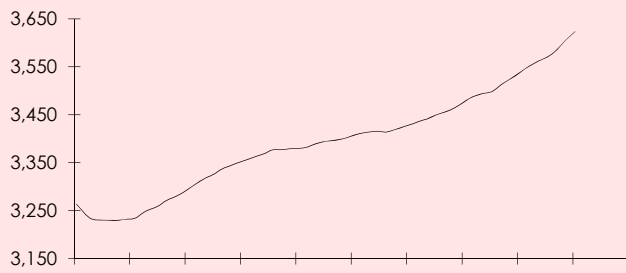
Indices of the assessment of the current economic situation and of business expectations, seasonally adjusted



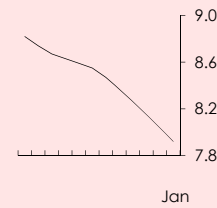
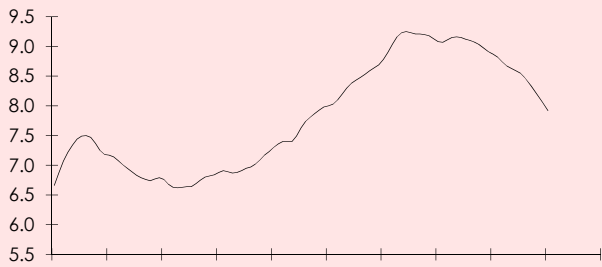
Source: WIFO-Konjunkturtest. Data refer to index points (percentage points) between +100 and -100. Values above 0 imply positive expectations, values below 0 indicate negative expectations.

Figure 3: Key economic indicators

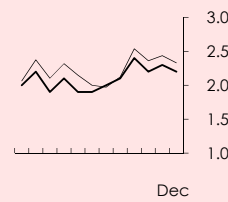
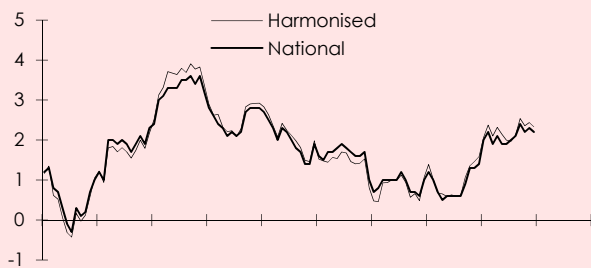
Persons in active dependent employment¹, 1,000s, seasonally adjusted



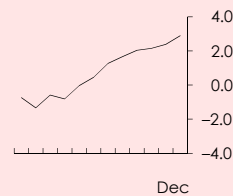
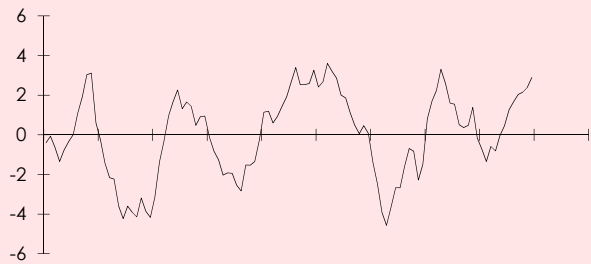
Unemployment rate, traditional Austrian method², seasonally adjusted



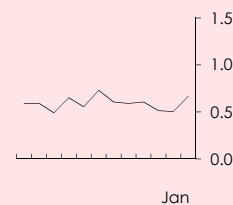
Consumer prices, year-to-year percentage changes



Real effective exchange rate, year-to-year percentage changes



10-year central government bonds (benchmark), percent



Source: Public Employment Service Austria, Main Association of Austrian Social Security Institutions, Oesterreichische Nationalbank, Statistics Austria, WIFO calculations. – ¹ Excluding persons in valid employment contract receiving child care benefit or being in military service. – ² As a percentage of total labour force excluding self employed, according to Public Employment Service.

In January, consumer confidence also remained as high as previously, according to the European Commission's business and consumer surveys; in the industrial and construction sectors, by contrast, sentiment deteriorated somewhat from high levels. All in all, economic activity is expected to remain robust also in the first few months of 2018.

4.2 Employment growing, unemployment declining

The situation in the Austrian labour market is improving further, owing to the good performance of the economy. According to provisional estimates, the number of persons in active dependent employment rose by 85,000 (+2.5 percent) in January, compared with a year before. Compared with a month before, the seasonally adjusted increase was 8,500 (+0.2 percent). Considerable employment gains were recorded in 2017 notably in the other business activities and manufacturing sectors.

In January, the number of persons registered as unemployed with the Public Employment Service (AMS) declined by 43,100 (-10.2 percent), compared with a year before; including persons enrolled in vocational training programmes, the number fell by 38,000 (-7.7 percent). On a seasonally adjusted month-on-month basis, the number of unemployed persons declined by 1.3 percent in January. Hence the seasonally adjusted unemployment rate according to the national definition dropped from 8 percent in December to 7.9 percent in January. Compared with a year before, the unemployment rate fell by 1.2 percentage points. A particularly sharp decline was recorded in the number of unemployed young people under 25 (-18.8 percent, compared with a year before). The number of long-term unemployed also declined rapidly (-10.8 percent). Unemployed persons aged 50 and older (-5.3 percent) and unemployed persons with health restrictions (-0.8 percent) have so far benefitted less from the increase in employment.

4.3 Inflation in Austria remains considerably higher than in euro area

Annual (CPI) inflation, at +2.2 percent, was slightly lower in December than in the previous months. Hence it was considerably higher than in the euro area as a whole (HICP Austria +2.3 percent, euro area +1.4 percent). Upward pressures in Austria came notably from price increases in the "housing, water, energy", "food and non-alcoholic beverages", "recreation and culture", "transport" as well as "restaurants and hotels" categories. The price index for the micro basket of goods (daily purchases) increased by 5.7 percent, compared with a year before, while that for weekly purchases rose by 4.1 percent. The core inflation rate (HICP) has followed a slight downward trend in recent months (December +2.3 percent).

Employment continues to grow markedly. The unemployment rate is gradually declining, but still very high in long-term comparison.

The inflation differential vis-à-vis the euro area average persists. Prices of goods purchased on a daily and weekly basis are rising sharply.