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Recovery on a Firmer Base

The cyclical upswing in the USA and Asia is increasingly spilling over to Europe. The strong increase in Austrian exports is gradually giving incentives to domestic corporate investment. Consumption by private households remains subdued, due, i. a., to higher fuel prices.

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The business cycle recovery in Austria has taken on momentum in the first half of 2004. Strong export gains were the main driving force which should give rise also to a revival of investment. High oil prices, however, are rekindling inflation and holding back the advance of real incomes.

The WIFO business survey of July yielded stronger indications for a business cycle upturn. Utilisation of firms' productive capacities increased, the order situation improved and expectations turned brighter. The production outlook in manufacturing for the next few months is positive on balance, even if the upward trend has levelled off recently. While output of basic goods, automotive components and investment goods appears to be on an upward trend, producers of food and non-durable consumer goods expect possible shortages of demand. The construction sector is reasonably confident, even if construction output posted only limited gains in the first half year.

Foreign demand is increasingly gaining momentum with the world-wide cyclical upswing and the stabilisation of the euro exchange rate. In March and April, Austrian exports rose 12 percent year-on-year, according to preliminary data. Deliveries to the USA and to southern Europe recorded particularly strong gains.

Consumers remained cautious, however, with real incomes flat. The oil-price-induced inflation is already outpacing contractual wage increases, and recipients of retirement benefits are suffering real income losses. Retail sales edged down by ¼ percent in volume in the first five months of this year. Private consumption overall increased slightly, owing to lively demand for motor cars and services. Unlike corporate sentiment, consumer confidence has not improved over the last few months.

Price developments are determined by the oil price hike. In early August, Brent crude was quoted above the threshold of 40 \$ per barrel. Headline inflation in Austria stood at a rate of 2.3 percent in June. Petrol and diesel were up by 15 percent or more from last year.

Even if oil prices, which are also subject to speculative buying, were to stay permanently around a high 40 \$ per barrel, economic growth in the industrialised countries should not be undermined severely. The WIFO projections of last June were based on the assumption of an oil price of 34.5 \$ per barrel. According to widely accepted model calculations, a sustained increase in the price for crude oil by 5 \$ per barrel takes 0.1 to 0.2 percentage points off GDP growth, by transferring purchasing power from the industrialised to the oil producing countries. The losses in purchasing power in the industrialised countries are reflected mainly in a flatter increase in real incomes and private consumption.