

Marcus Scheiblecker

# Global Economy in Best Shape

## Business Cycle Report of November 2017

### Global Economy in Best Shape. Business Cycle Report of November 2017

The Austrian economy continues its upswing. Sentiment indicators have reached record highs in the euro area and the EU as a whole. The US economy once again grew vigorously in the third quarter. In these economic regions, stock exchange prices continue their sharp upward trajectory. Emerging market economies participate in this currently robust global economic activity and report a further improvement in their economic performance.

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In the USA, GDP growth in the third quarter, at +0.7 percent compared with the previous quarter, maintained the same strong momentum as in the second quarter. Consumer confidence has been very high already for several months, suggesting that private demand will remain lively in the coming months; in October, this indicator rose again sharply, reaching the highest level since 2000. This euphoric sentiment is believed to be largely due to the extraordinarily low unemployment rate and to stock markets hitting record highs. Inflation has been rising continuously in the USA since the beginning of the summer, and stood at 2.2 percent in September; it was driven by buoyant economic activity, but to a large extent also by increases in crude oil prices. The Fed took its last interest rate action so far in June, and since then has been hesitant to further tighten its monetary policy.

Momentum remains strong in the euro area. Following an upward revision of second-quarter GDP growth to +0.7 percent, provisional estimates for the third quarter showed a further increase of 0.6 percent. The momentum is expected to be sustained also in the fourth quarter; companies are currently optimistic regarding their business situation. The European Economic Sentiment Indicator is clearly trending upward in all EU countries. In the euro area, the unemployment rate fell to 8.9 percent (seasonally adjusted) in September, the lowest level since 2009. Euro area inflation rose markedly at the beginning of 2017, driven by a pick-up in energy prices; since then, however, inflation has not risen further and according to first estimates was 1.4 percent in October, down from September. The ECB intends to scale back the volume of its asset purchase programme from 2018 onwards; it has so far left the key interest rate unchanged.

In this dynamic international environment, the upturn in Austria's export-oriented economy continues. According to WIFO's Flash Estimate, GDP in the third quarter grew again by 0.8 percent in real terms, quarter on quarter (trend-cycle compo-

ment). All demand components contributed to growth. Private consumption benefited from favourable labour market developments, which considerably raise people's willingness to consume. At +0.7 percent, gross fixed capital formation grew less briskly than in the second quarter, but nevertheless also supported economic growth.

The WIFO-Konjunkturtest (business cycle survey) among Austrian companies points to buoyant economic activity also beyond the turn of the year. Companies' optimism regarding developments over the next three months is unbroken and is visible across all sectors of the economy. Consumer confidence is also high and confirms the picture of the currently buoyant demand.

Inflation rose to 2.4 percent in September, according to the national definition, and to 2.6 percent, as measured by the Harmonised Index of Consumer Prices. Hence the inflation differential vis-à-vis the euro area was back to around 1 percentage point.

The situation in the Austrian labour market is easing further, reflecting the robust economic activity. In October, the unemployment rate fell to 7.9 percent, while active dependent employment increased by 1.9 percent compared with a year before, according to first estimates.

## 1. Economic momentum remains high in the USA

In the third quarter, the US economy grew by 0.7 percent, the same robust pace as in the previous quarter, despite a decline in production owing to the hurricanes. Hence the multi-year upturn is continuing. However, all main demand components except inventory accumulation expanded at a slower pace than in the second quarter.

The unemployment rate keeps falling on the back of the buoyant economy. Adjusted for seasonal effects, at 4.1 percent in October, it was lower than the lowest level during the boom in May 2007. Such a low rate was last recorded in 2000.

Economic conditions should remain favourable also at the beginning of 2018; this is underpinned by consumer sentiment, which in October rose to its highest level in 16 years, and the persistently high level of the Purchasing Managers' Index.

The length of the current economic upturn as well as the low level of unemployment point to a very mature phase of the economic cycle, which is generally soon followed by a downturn. However, so far there have been barely any signs of stress that would raise doubts about the sustainability of the current economic development. According to the S&P/Case-Shiller Index, real estate prices reached the peak levels seen in 2006 already at around the turn of the year 2016-17, and have been rising slightly further since then. However, neither household debt nor borrowing levels are alarmingly high.

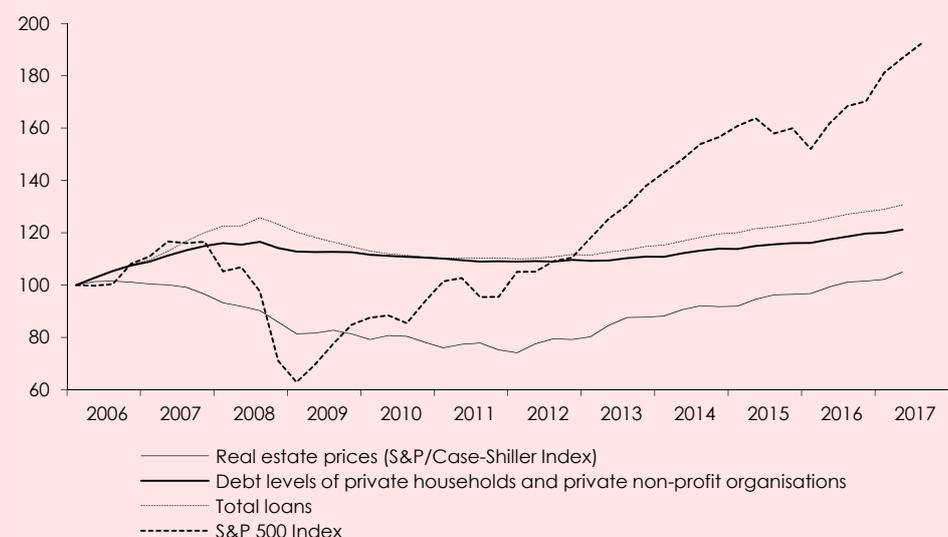
The inflation rate also does not yet point to excessive consumer demand as can usually be observed in the late stage of an upturn. In September, the consumer price index rose by 2.2 percent, year on year, largely owing to a 10-percent price increase for energy commodities. Core inflation (excluding food and energy), by contrast, was 1.7 percent, unchanged from previous months.

Unlike real estate prices, most recent price developments in stock markets more likely suggest a speculative bubble. Since its peak in 2007, the S&P 500 Index for the USA has advanced by almost 70 percent (Figure 1). Moreover, the pace of the increase has accelerated markedly: since the first quarter of 2017, the index has risen by almost 30 percent. In much the same way as before the bursting of the dot-com bubble in 2001, investors' excessive expectations for the future are pushing technology stock prices up. For instance, the stock market value of the electric car manufacturer Tesla is substantially higher than those of traditional vehicle manufacturers, despite the fact that unlike the latter, Tesla has not made any profit yet. The rapid rise of the exchange rate of the Bitcoin cryptocurrency is also proof of investors' current appetite for speculation.

*The long upturn in the USA has been accompanied by only little stress so far.*

Figure 1: US wealth and financial market indicators

First quarter of 2006 = 100



Sources: Standard & Poor's, S&P Dow Jones Indices McGraw Hill Financial, Federal Reserve (Flow of funds), Macrobond.

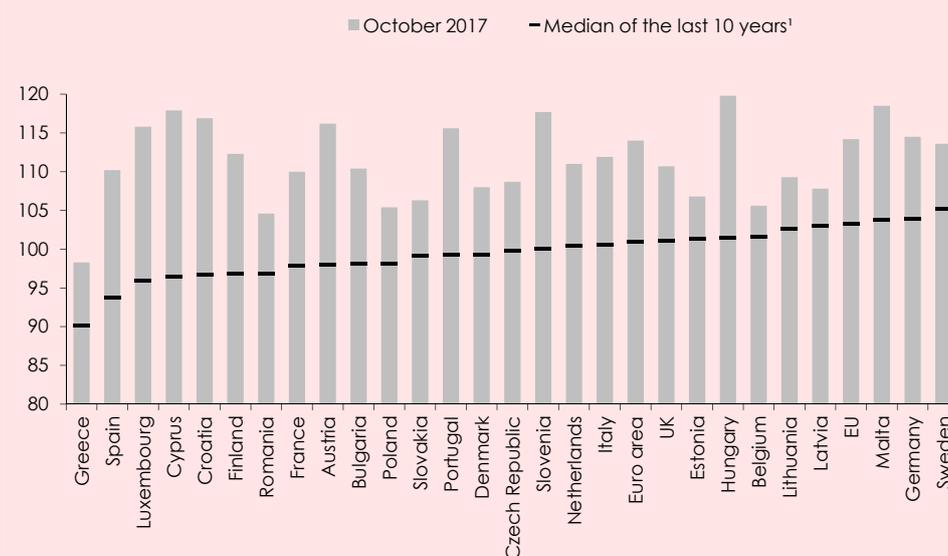
## 2. Significant acceleration in activity in euro area and EU

The upturn in Europe continued in the third quarter of 2017. However, growth has so far not accelerated, despite steadily improving assessments of business conditions in business surveys. According to Eurostat's flash estimate, GDP grew by 0.6 percent in both the euro area and the EU as a whole in the third quarter. Hence economic growth has been fluctuating between 0.6 and 0.7 percent in both economic regions already since the fourth quarter of 2016.

Owing to the vigorous economic expansion, unemployment is falling quickly in Europe. If its decline continues at the present pace, it should be possible to reach the level prior to the 2008-09 financial market and economic crisis in mid-2018 (EU) and at the end of 2018 (euro area), respectively.

Figure 2: Current assessment of economic development in EU countries

Economic Sentiment Indicator, seasonally adjusted



Sources: European Commission, WIFO calculations.— <sup>1</sup> Croatia: median of the last 9 years.

The breadth of the momentum is encouraging: as the results of the EU business cycle surveys show, all countries are currently participating in the international cycle (Fig-

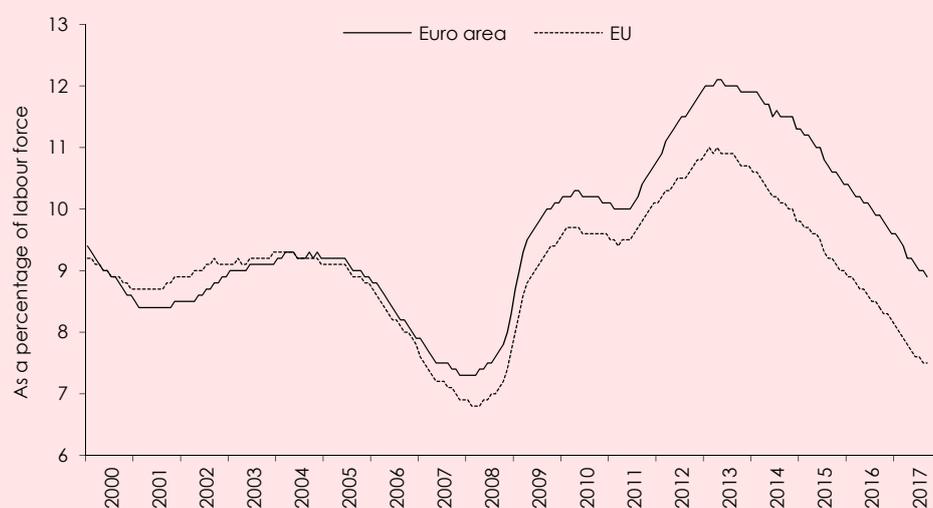
ure 2). This gives those economies at the periphery of the euro area that remained mired in a phase of weakness for a long time the opportunity to get out of the economic policy dilemma between public sector balance sheet repairs and a stimulation of demand.

The situation of banks is also stabilising further, although holdings of non-performing loans are still sizeable. The economic crisis of recent years appears to have finally been overcome. Recessions caused by financial market crises seem to be particularly tenacious. According to *Reinhart – Rogoff (2009)*<sup>1</sup>, surmounting them takes up to 10 years. Apart from the continuing high levels of government debt in the wake of the crisis, economic policy nevertheless remains in crisis mode. The ECB, for instance, is continuing its government Bond Purchase Programme and keeping the key interest rate at around 0 percent. Fiscal policy in the euro area has also not yet returned to normal, owing to a late reaction to the crisis of recent years. While the general government fiscal position of the member countries is improving thanks to the effect of automatic stabilisers, discretionary measures taken in recent years are dampening the impact on net lending/borrowing.

The ongoing acceleration in activity is clearly reflected in the EU labour market. Since the crisis-related peaks of 12.1 percent in the euro area and 11 percent in the EU as a whole in 2013, unemployment rates have been falling steadily and recorded lows of 8.9 percent in the euro area and 7.5 percent in the EU (seasonally adjusted) in September. To reach the pre-crisis levels at the beginning of 2008, they would have to decline by another 1½ percentage points in the euro area and ¾ percentage point in the EU as a whole. Provided the downward movement witnessed in the last 12 months continues, these levels should be reached in mid-2018 and at the end of 2018, respectively (Figure 3).

Figure 3: Harmonised unemployment rates in the euro area and the EU

Seasonally adjusted, ILO definition



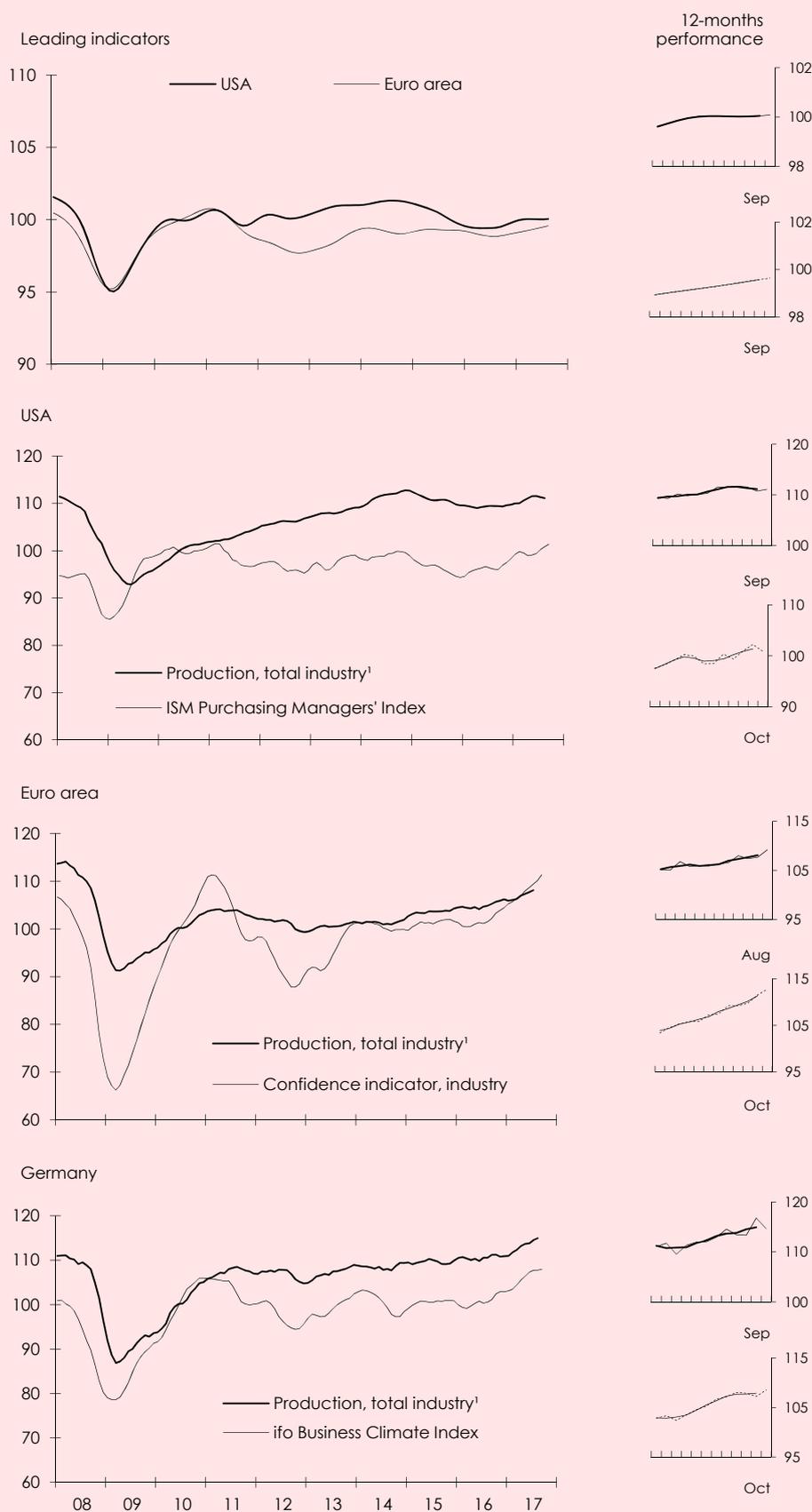
Sources: Eurostat, Macrobond.

But unemployment is still very unevenly distributed across the EU countries. Spain, for instance, recorded the sharpest decline in the unemployment rate, owing to the extremely vigorous economic growth experienced in recent years (July 2013: 26.3 percent, September 2017: 16.7 percent). Spain's rate nevertheless remains the second highest in the EU, after that of Greece (July 2017: 21 percent) and before Italy's (11.1 percent).

<sup>1</sup> Reinhart, C.M., Rogoff, K.S., *This time is different: Eight Centuries of Financial Folly*, Princeton University Press, 2009.

Figure 4: 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. – <sup>1</sup> Excluding construction.

In Germany, the unemployment rate fell to an all-time low of 3.6 percent in September. In the EU, only the Czech Republic recorded a lower rate (2.7 percent). With a rate of 5.6 percent, Austria ranked tenth among the 28 member countries.

Business surveys suggest that economic activity in the EU and the euro area will remain buoyant beyond the turn of the year. In October, industrial confidence, which is reflected in the European Economic Sentiment Indicator and is the most important cyclically driven sub-component, continued its steep rise. Consumer confidence also rose slightly in October from the peak reached in September.

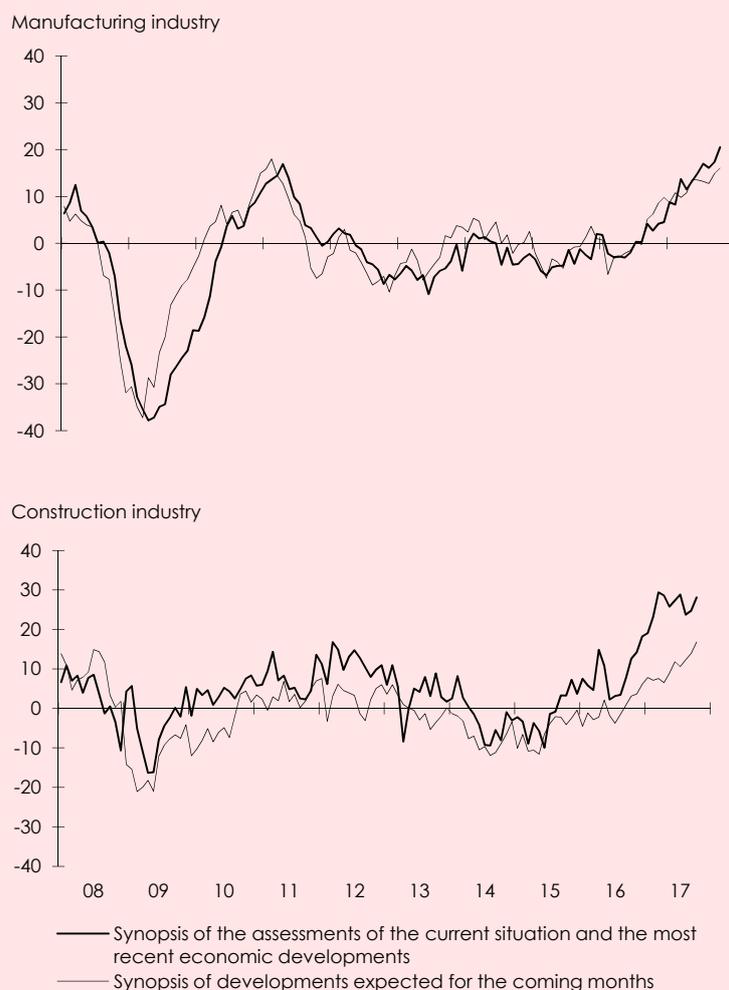
### 3. Persistently brisk economic growth in Austria

The Austrian economy continued to expand vigorously in the third quarter of 2017, according to WIFO's Flash Estimate, but in contrast with the development of business cycle surveys did not show an accelerating trend. At +0.8 percent in real terms, quarter on quarter (trend-cycle component), GDP increased at approximately the same pace as in the previous two quarters.

*The Austrian economy continues to grow vigorously. However, similarly as in the entire euro area, the pace of the expansion has not accelerated so far, despite companies' continuously improving assessment of the present situation. In contrast with the development of the sentiment indicators, the growth momentum lags behind that of previous upswing phases.*

Figure 5: 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.

The upswing is supported by all main demand components. Private consumption increased at a robust pace of 0.4 percent in real terms, somewhat faster than in the

previous quarter and at the same rate as government consumption. While the positive effects of the tax reform are assumed to have ended by now, the favourable development of the labour market is having a growing impact.

Gross fixed capital formation is still growing strongly compared with a year before, but compared with the previous quarter, the pace of growth continues to slow. However, this is likely due less to companies' economic expectations than to the lively investment activity in 2016, an unusually early phase of the upswing. This development was reflected in the two important components: equipment investment (third quarter +0.8 percent in real terms, second quarter +1.6 percent) and construction investment (+0.3 percent and +0.8 percent, respectively).

Similarly, following quite a sharp increase in the first quarter (exports +2.1 percent in real terms, imports +1.6 percent), foreign trade momentum moderated over the course of the year (third quarter +0.8 percent each).

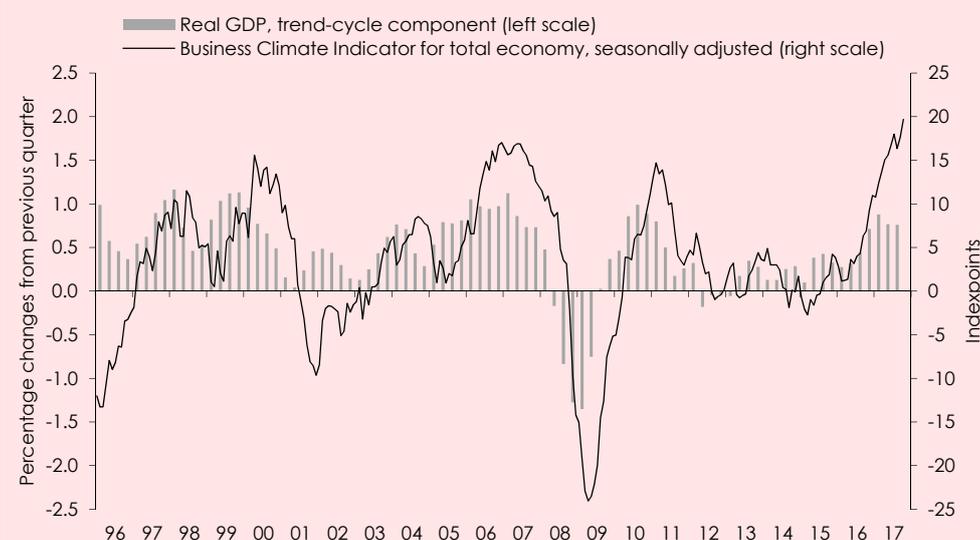
Aggregate production, on the other hand, expanded at a very steady pace. After +0.9 percent in the first quarter, economic growth was +0.8 percent in both the second and the third quarter. As the main demand components were not able to completely absorb the production, this led to considerable inventory accumulation in the second and the third quarter.

### 3.1 Business surveys reach new peaks

The WIFO-Konjunkturtest has reflected a considerably more optimistic sentiment in recent months than the GDP growth rate would suggest. In the October survey, the index reflecting the current business situation for the economy as a whole reached a new peak. The respective values have been very high already since the beginning of 2017 and have risen further in the course of the year. In the past, optimistic assessments were often accompanied by GDP growth rates of more than 1 percent. In the current upswing, which has lasted since the beginning of 2016, no equivalent growth rates have been recorded so far (Figure 4). The same holds for the euro area and the EU as a whole: sentiment is much better than the economic expansion would suggest. While it is true that it is not possible to conclude a certain growth rate purely from the construction of the questions in business cycle surveys, it should, however, be possible to construe with reasonable reliability acceleration or deceleration trends of economic activity. Hence an explanation that is based on decelerated GDP trend growth appears to be inadequate. Therefore it remains to be seen whether or not the improved sentiment will be reflected in a stronger acceleration of economic growth in the coming quarters.

*The WIFO Business Climate Indicator for the economy as a whole reached a new peak in October 2017.*

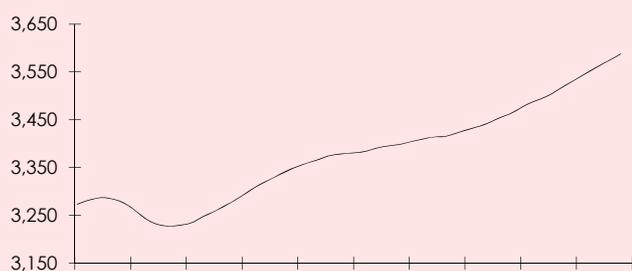
Figure 6: Business sentiment and development of GDP



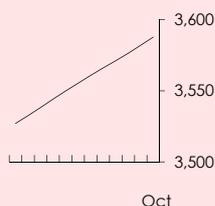
Source: WIFO.

Figure 7: Key economic indicators

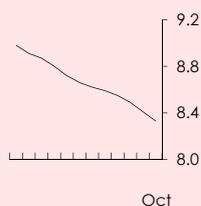
Persons in active dependent employment<sup>1</sup>, 1,000s, seasonally adjusted



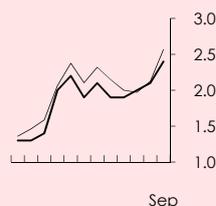
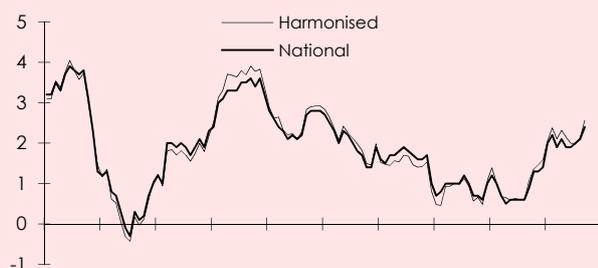
12-months performance



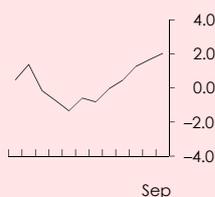
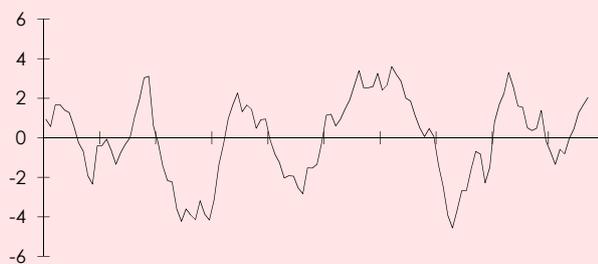
Unemployment rate, traditional Austrian method<sup>2</sup>, seasonally adjusted



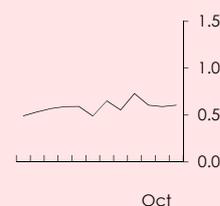
Consumer prices, year-to-year percentage changes



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



10-year central government bonds (benchmark), percent



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

Austrian companies not only gave an extremely positive assessment of the current business situation, but the index of the business expectations also reached a new peak. The optimism is visible in all key sectors. In the services sector, the expectations index rose by 2.9 points compared with the previous month. The index reading of 19.2 points on balance signals highly optimistic economic expectations. In construction, the expectations index also increased markedly (+2.9 points) and, at 16.8 points, exceeded the record high last achieved in summer 2008. The expectations index also gained 1.2 points in manufacturing, an important sector for economic activity, and stood at 16.0 points in the area of highly optimistic economic expectations. Hence Austrian companies expect the economic upswing witnessed since the beginning of 2017 to continue into 2018.

### 3.2 Inflation rate continues to exceed euro area average

While euro area inflation remained unchanged at 1.5 percent in August and September, inflationary pressure intensified in Austria. Statistics Austria reported an increase in the harmonised index of consumer prices of 2.1 percent in August and 2.6 percent in September. Thus the inflation differential vis-à-vis the euro area is again around 1 percentage point.

The inflation rate according to the national definition rose from 2.1 percent in August to 2.4 percent in September, with food, fuels, newspapers and periodicals as well as accommodation services having the strongest upward impact on inflation, in addition to expenditure on recreation and culture. Rentals for housing also rose substantially compared with a year before (+4.3 percent), whereas substantial price declines were registered for electricity (-5.5 percent) and for telephone and telefax services (-3.4 percent).

### 3.3 Cyclically-related unemployment continues to decline

The sharp employment growth in the course of the economic upturn continues to exceed the inflow to the Austrian labour market, with unemployment declining as a result.

In October, the number of persons in active dependent employment increased by 68,000 compared with a year before (+1.9 percent), according to first estimates. Hence the pace of the increase accelerated slightly compared with the previous month (September +1.8 percent).

At the same time the number of persons registered as unemployed with the Public Employment Service (AMS) dropped by around 25,000 in October (-7.4 percent, compared with a year before). Thus the seasonally adjusted unemployment rate also declined from 8.4 percent in September to 8.3 percent in October. However, the number of unemployed persons with health problems increased, and the decline in the unemployment rate for older people was comparatively small. This contributes to an increase in the share of long-term unemployment.

The demand for labour continues to rise on the back of persistently favourable cyclical conditions. In October, the number of reported job vacancies increased from 60,000 to 60,500 (seasonally adjusted). A year ago it had still amounted to 45,100.

*The unemployment rate in Austria has recently declined to its lowest level since 2014.*