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# Cautious Economic Revival Continuing

## Business Cycle Report of March 2010

**The latest data on the global economic situation, while generally suggesting a continuation of the upswing, are somewhat mixed. Growth in the USA and in South-East Asia remains robust, although it appears to have moderated in the first quarter. Private demand in the euro area continues to be subdued. Austria's GDP grew at a seasonally and working day adjusted quarter-on-quarter rate of 0.4 percent in the fourth quarter of 2009.**

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According to WIFO's provisional quarterly national accounts estimate, Austria's GDP grew at a seasonally and working day adjusted quarter-on-quarter rate of 0.4 percent in the fourth quarter of 2009. Growth was driven by exports (+1.6 percent) and private consumption (+0.2 percent), whereas gross fixed capital formation declined further (-1.6 percent).

Manufacturing value added increased by 1.3 percent (seasonally adjusted) quarter-on-quarter in the fourth quarter (third quarter +1.9 percent). Developments were more unfavourable in sectors more strongly oriented toward domestic demand. Value added remained flat in the construction sector as well as in the services sectors trade, accommodation and transport.

The global economic recovery continued in the first two months of 2010. The USA and South-East Asia had registered strong economic growth in the fourth quarter, supported by fiscal stimuli in the USA and China and a revival of world trade that was accompanied by a rapid re-stocking of inventories. The expansion in the USA appears to have slowed down somewhat in the first quarter of 2010, but is expected to remain robust. Sentiment indicators were mixed in February, and the re-stocking of inventories might lose some momentum. At the same time there is some indication that the upswing in the USA is now reaching the business sector: Investment is no longer declining, and the situation in the labour market has stabilised, albeit at an unemployment rate of 9.7 percent.

The euro area registered quarter-on-quarter growth of only 0.1 percent in the fourth quarter. Private consumption remained flat (0.0 percent), and fixed capital formation declined further; only exports were lively (+1.7 percent). But, given the development of exports and other indicators, GDP growth may have been somewhat underestimated in the fourth quarter (discussions about working day adjustment). This could be offset in the first quarter of 2010. However, available indicators suggest that growth may remain modest in the first two months of 2010. While business expectations in the industrial sector did again improve slightly in February, consumer confidence softened, possibly in reaction to the crisis in Greece. It turned attention to macroeconomic imbalances in some Southern European countries that might further hamper developments in the euro area in 2010.

Crude oil prices have stabilised at \$ 80 per barrel in recent months. However, they clearly exceed the levels seen at the beginning of 2009, and have thus prompted a slight increase in the rate of inflation in recent months. In January, inflation stood at

2.6 percent and 1.0 percent in the USA and the euro area, respectively; inflation excluding food and energy was 1.6 percent and 0.9 percent, respectively.

Table 1: Quarterly national accounts

			2008		2009			
			Third quarter	Fourth quarter	First quarter	Second quarter	Third quarter	Fourth quarter
Percentage changes from previous quarter								
<i>Adjusted for seasonal and working day effects, volume</i>								
Final consumption expenditure			- 0.2	+ 0.5	- 0.2	+ 0.4	+ 0.8	+ 0.2
Households <sup>1</sup>			+ 0.1	+ 0.1	+ 0.2	+ 0.3	+ 0.3	+ 0.2
General government			- 0.8	+ 1.6	- 1.5	+ 0.3	+ 1.6	+ 0.1
Cross capital formation			- 2.1	- 3.2	- 2.2	- 2.2	- 1.2	- 1.0
Gross fixed capital formation			- 1.5	- 2.9	- 3.3	- 1.2	- 1.1	- 1.6
Machinery and equipment			- 1.8	- 2.8	- 2.9	- 2.6	- 2.2	- 2.0
Construction			- 1.2	- 1.6	- 1.7	- 1.1	- 0.5	- 0.8
Exports, goods and services			- 2.7	- 5.9	- 7.3	- 2.9	+ 0.7	+ 1.6
Goods			- 2.8	- 7.5	- 9.8	- 3.4	+ 1.6	+ 2.3
Services			- 1.5	- 2.3	- 2.7	- 2.5	- 2.2	- 2.0
Imports, goods and services			- 3.0	- 4.2	- 5.7	- 2.7	+ 0.4	+ 1.1
Goods			- 3.4	- 4.2	- 6.3	- 2.9	+ 0.7	+ 0.9
Services			- 2.4	- 3.3	- 2.9	- 2.0	- 1.1	- 0.4
Gross domestic product			- 0.6	- 1.3	- 2.2	- 0.5	+ 0.5	+ 0.4
Manufacturing			- 2.2	- 5.4	- 6.2	- 2.0	+ 1.9	+ 1.3
	2008	2009	2008		2009			
			Third quarter	Fourth quarter	Third quarter	Fourth quarter	Third quarter	Fourth quarter
Percentage changes from previous year								
<i>Volume, chained prices</i>								
Final consumption expenditure	+ 1.4	+ 0.6	+ 1.6	+ 0.8	- 1.0	+ 0.8	+ 0.9	+ 1.5
Households <sup>1</sup>	+ 0.8	+ 0.4	+ 1.4	+ 0.2	- 2.6	+ 1.4	+ 0.8	+ 1.8
General government	+ 3.2	+ 1.2	+ 2.2	+ 2.7	+ 3.4	- 0.6	+ 1.4	+ 0.7
Cross capital formation	+ 0.3	- 9.3	- 1.9	- 4.9	- 4.4	- 12.0	- 9.4	- 10.2
Gross fixed capital formation	+ 1.0	- 7.8	- 0.1	- 0.7	- 10.8	- 10.0	- 5.5	- 5.2
Machinery and equipment	- 0.0	- 12.1	- 1.8	- 3.0	- 9.3	- 17.2	- 12.0	- 9.9
Construction	+ 1.8	- 6.1	+ 0.9	+ 0.9	- 14.2	- 6.9	- 2.6	- 3.2
Exports, goods and services	+ 0.8	- 15.5	+ 1.6	- 8.5	- 18.5	- 20.6	- 15.7	- 6.7
Goods	+ 0.2	- 17.7	+ 2.0	- 11.1	- 21.8	- 23.7	- 17.6	- 6.5
Services	+ 2.3	- 9.6	+ 0.4	- 1.3	- 10.6	- 10.3	- 10.4	- 7.3
Imports, goods and services	- 0.7	- 13.6	- 2.8	- 5.8	- 15.6	- 17.6	- 13.3	- 7.7
Goods	- 0.5	- 14.7	- 3.0	- 5.3	- 16.8	- 18.9	- 14.2	- 8.8
Services	- 1.8	- 8.9	- 2.0	- 7.7	- 10.2	- 12.0	- 10.1	- 3.4
Gross domestic product	+ 2.0	- 3.6	+ 2.3	- 0.3	- 4.9	- 5.1	- 3.2	- 1.4
Manufacturing	+ 3.9	- 11.7	+ 6.0	- 1.4	- 14.2	- 15.9	- 11.3	- 5.2
Gross domestic product, value	+ 4.1	- 1.8	+ 4.6	+ 0.3	- 3.0	- 3.3	- 1.4	+ 0.6

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

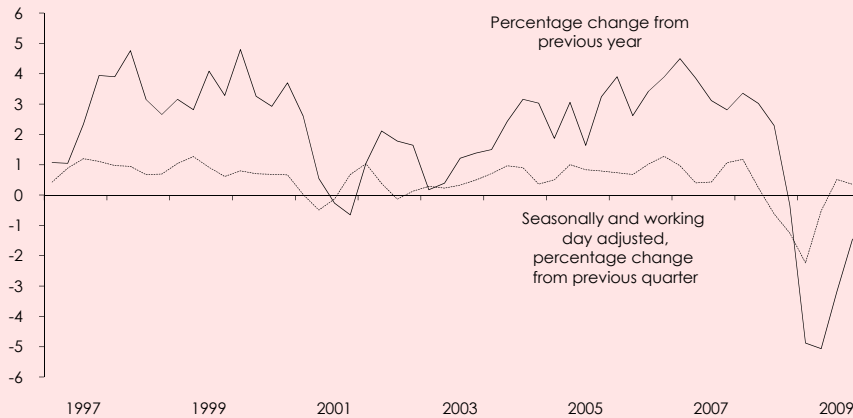
WIFO's February business cycle survey shows a further improvement of business expectations in the industrial sector also in Austria. The construction sector, by contrast, shows hardly any signs of recovery. Construction investment fell in the fourth quarter (-0.8 percent), compared with the previous quarter. The weak trend is expected to persist in the first quarter due to the cold weather.

Tourism sales in the first half of the winter season did drop 3 percent below last year's record result, according to first estimates, but the decline was small by international standards and weaker than had been feared in the face of the financial crisis. Apparently both resident travellers and guests from neighbouring countries chose a stay in Austria over expensive long-haul trips.

The situation in Austria's labour market remained unchanged in the first two months of the year. The seasonally adjusted number of persons in active dependent employment rose marginally. In February, it thus remained 0.5 percent below the year-earlier level. The seasonally adjusted unemployment rate picked up slightly in February (according to the Austrian definition), to 7.5 percent, an increase of 0.8 percentage point from a year before. CPI inflation stood at 1.2 percent in January, while inflation excluding unprocessed food and energy was 1.1 percent.

Figure 1: Growth of real GDP

Percentage changes from previous period



Source: WIFO.

According to the latest estimate, the US economy registered extraordinarily brisk quarter-on-quarter growth (+1.4 percent) in the fourth quarter. This was largely (+0.9 percentage points) attributable to inventory investment, which was accompanied by a sizeable expansion of merchandise exports (+7.6 percent) and imports (+4.7 percent). But fixed capital investment also grew again for the first time since mid-2007 (+1.5 percent). Private consumption remained stable (+0.4 percent), while the savings rate settled down at 4 percent.

The unemployment rate fell slightly at the beginning of the year and in February stood at 9.7 percent (seasonally adjusted), 0.4 percentage points below its peak in October 2009. Employment did continue to decline moderately in February, but survey evidence suggests that companies plan to create additional jobs. This development is in line with the usual pattern whereby the labour market reacts to cyclical fluctuations with a lag of around two quarters. Labour shedding had led to substantial gains in productivity last year, with companies consequently turning largely profitable again. The recovery thus appears to be reaching the corporate sector.

Latest survey results are rather mixed. Growth in the first quarter is therefore expected to be smaller than in the fourth quarter. The Purchasing Managers' Index (PMI) for manufacturing fell somewhat month-on-month in February, mainly in reaction to a drop in new orders. Consumer confidence posted quite a substantial decline in February. The Purchasing Managers' Index for the services sector, on the other hand, rose appreciably.

Japan recorded growth of 1.1 percent in the fourth quarter of 2009 (quarter-on-quarter). Euro area GDP, by contrast, expanded by a mere 0.1 percent in the fourth quarter of 2009. Only net exports contributed positively to growth. Private and public consumption expenditure stagnated and so did inventory investment, while capital fixed investment declined.

The expansion in the euro area is expected to remain modest also in the first quarter. Admittedly, fourth quarter growth may have been underestimated due to statistical effects connected with the working day adjustment of production; such an effect should be offset by a higher growth rate in the first quarter of 2010. But sentiment in the euro area has not improved appreciably: The European Commission's Economic Sentiment Indicator stagnated in February. The Industrial Confidence Indicator did rise somewhat – notably firms' business expectations brightened further – but the trade and consumer confidence indices declined. The Ifo Business Climate Index for Germany also fell slightly. Apart from the surveys, only few data are yet available for the first quarter. A moderate decline in euro area retail trade in January 2010 and a drop in German exports confirm the picture.

## Developments of global economy uneven

*Global sentiment indicators were mixed in February.*

The crisis of government indebtedness in Greece may have contributed to the deterioration in the consumer climate in the euro area. In recent weeks, the euro has lost around 7 percent of its value against the dollar. However, such fluctuations have occurred repeatedly in the last ten years, and the euro-dollar rate is still clearly above its average for the last ten years.

The interest rates for Greek government bonds occasionally were almost 4 percentage points higher than those for German bonds. An interest differential of this magnitude alone would have raised Greek government expenditure by around 5 percent of GDP. The announcement of the savings package has now brought the interest differential down to just over 3 percentage points.

Crude oil prices have stabilised in recent months. After peaking at around \$ 140 per barrel in July 2008, Brent crude prices fell in the course of the crisis and until March 2009 moved in the range of around \$ 40 to \$ 50. They recovered thereafter, and since October 2009 have been quite stable at around \$ 80. The prices of other commodities took a similar course, albeit with smaller fluctuations.

As it measures price developments over a year, the inflation rate picked up slightly in the last few months owing to still high commodity prices compared with a year earlier. In January, inflation stood at 2.6 percent in the USA and 1.0 percent in the euro area. Inflation excluding food and energy was 1.6 percent in the USA and 0.9 percent in the euro area in January.

The current crisis in Greece was unleashed when it became known that budget data had been manipulated. But ultimately the crisis is the result of macroeconomic imbalances built up in the years prior to the financial market crisis. These imbalances affect not only Greece, but to a varying extent also Ireland, Spain and Portugal. After initially favourable developments, all these countries registered a loss in competitiveness vis-à-vis other euro area countries due to extraordinarily high inflation rates. These countries appreciated in real terms vis-à-vis the EU-15 countries: Between 1998 and 2008 their real effective exchange rates rose by 11 to 23 percent (Table 2). Consequently, these countries have registered high current account deficits of late.

## Imbalances in the euro area

Table 2: Current account and effective exchange rate

	Germany	Greece	Spain	Ireland	Portugal
Current Account 2008, as a percentage of GDP	6.6	- 14.5	- 9.5	- 5.3	- 12.1
Real effective exchange rate <sup>1</sup> , percentage change 1998-2008	- 13.8	+ 10.7	+ 16.0	+ 22.9	+ 11.3

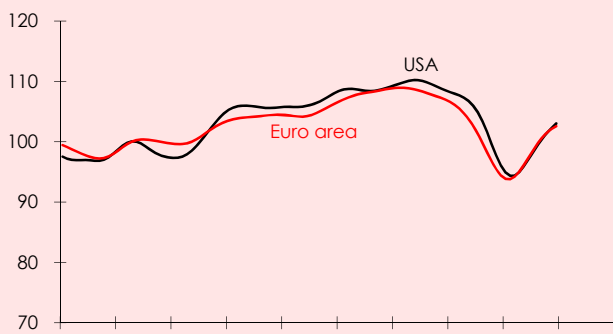
Source: European Commission, OECD. – <sup>1</sup> Vis-à-vis the EU 15, measured by unit labour costs in total economy.

The country-specific causes of this development will yet have to be examined in detail. The economic catching-up process of these countries may be assumed to have played some role here, given that it contributed relatively quickly to higher inflation compared to other euro zone members. While the export-oriented industrial sector suffered because of the loss of competitiveness, domestic sectors benefited from the low real interest rates. This, in turn, may have been one of the causes of the overheating of the economy and the development of speculative bubbles in the housing sector.

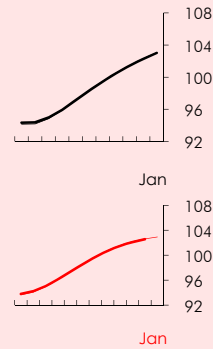
Figure 2: International business climate

Seasonally adjusted, 2000 = 100, 3-month moving average

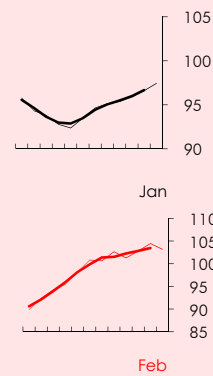
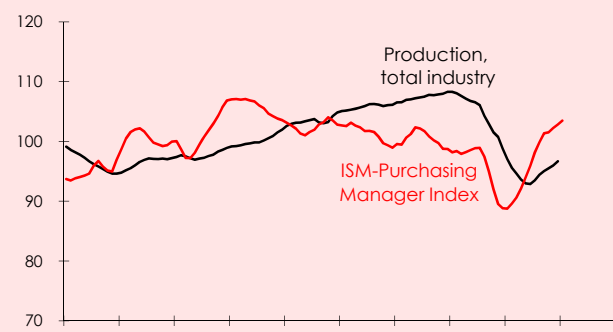
Leading indicators



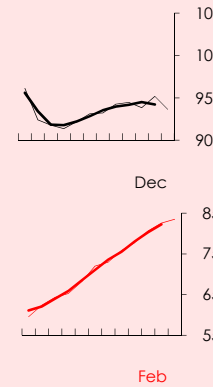
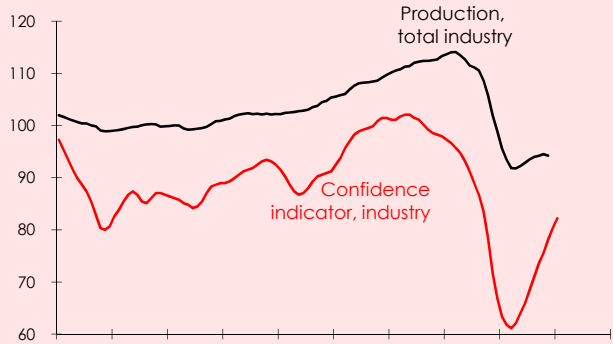
12-month performance



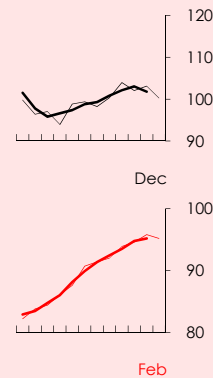
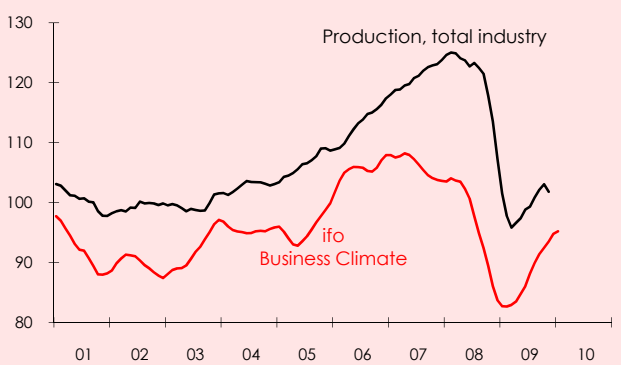
USA



Euro area



Germany



Source: European Commission, Deutsche Bundesbank, ISM (Institute for Supply Management™), ifo (Institute for Economic Research, Munich), OECD.

According to WIFO's most recent quarterly national accounts, Austria's economy grew at a seasonally and working day adjusted rate of 0.4 percent in real terms in the fourth quarter, after +0.5 percent in the third quarter. Overall, GDP declined by 3.6 percent in 2009, compared with 2008.

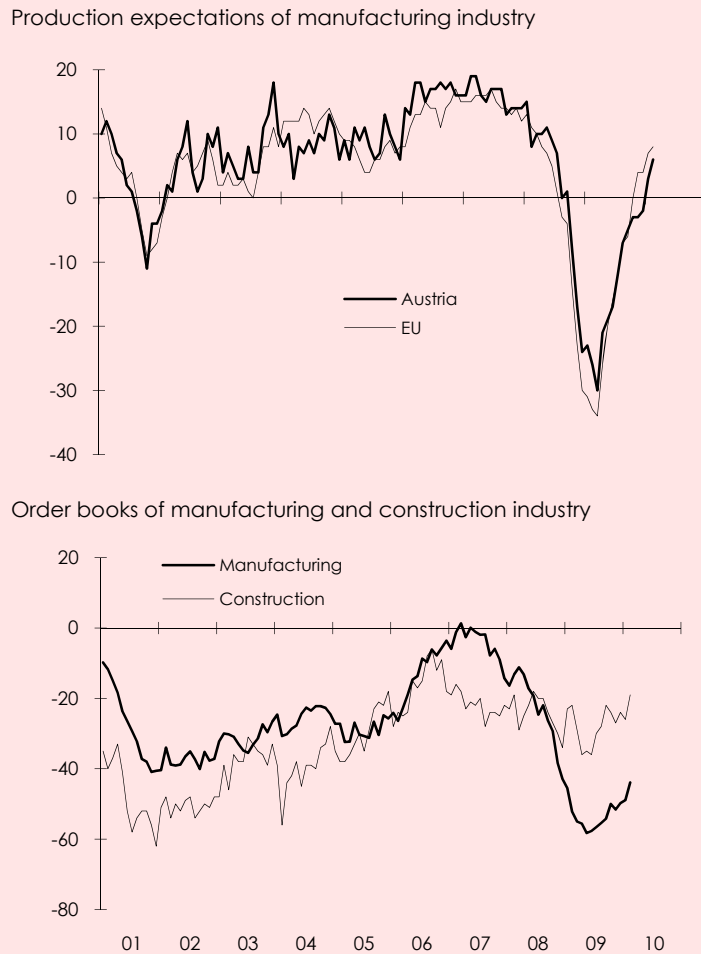
The manufacturing sector continued its recovery, with seasonally adjusted value added increasing by 1.3 percent quarter-on-quarter (third quarter +1.9 percent). Goods exports rose by 2.3 percent (third quarter +1.6 percent), while goods imports increased by 0.9 percent (third quarter +0.7 percent).

## Austria's economy expanded in fourth quarter

Austria's GDP grew at a seasonally adjusted quarter-on-quarter rate of 0.4 percent in the fourth quarter of 2009.

Figure 3: 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.

The services sectors with a stronger orientation toward domestic demand fared less favourably. Seasonally adjusted construction investment declined yet again quarter-on-quarter in the fourth quarter (-0.8 percent, third quarter -0.5 percent). Value added remained stable both in construction and the services sectors trade, hotels and restaurants, and transport (third quarter -0.3 percent and -0.1 percent, respectively).

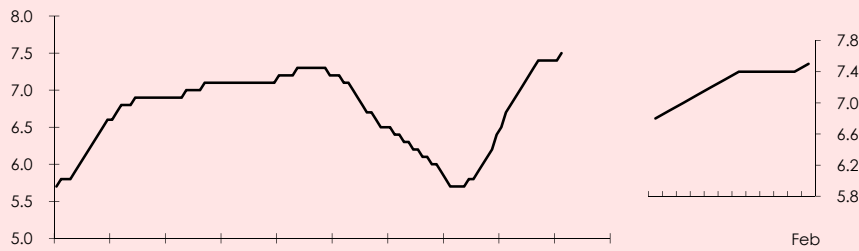
Business spending on machinery and equipment fell by 2 percent (third quarter -2.2 percent). It is likely to be dampened also in 2010 by large excess capacity. Private consumption advanced by 0.2 percent (seasonally and selling day adjusted) quarter-on-quarter in the fourth quarter (third quarter +0.3 percent). Retail sales have fared well of late, exceeding the year-earlier level by 0.5 percent in real terms in January.

Figure 4: Key economic indicators

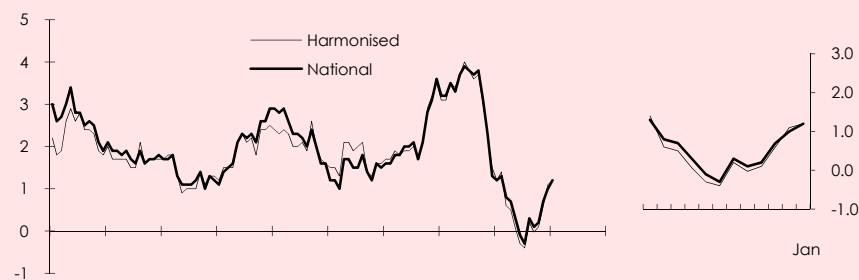
Persons in active dependent employment<sup>1</sup>, (1,000), seasonally adjusted



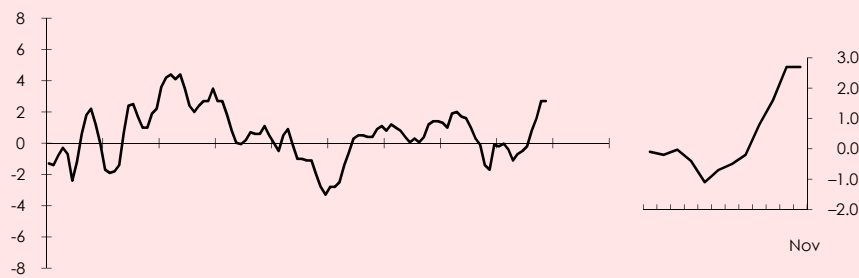
Unemployment rate, traditional Austrian method<sup>2</sup>, seasonally adjusted



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.

Sentiment in the Austrian economy improved further, albeit only slightly, in February, according to WIFO's business cycle survey. In manufacturing and services, production expectations and expectations regarding the business situation were in line with their long-run averages or even slightly higher. The assessment of current order books brightened somewhat, but remained at a rather low level. The proportion of manufacturers judging their order books to be sufficient or more than sufficient slightly exceeded 50 percent.

Austria's construction sector continues to fare rather badly, despite the economic stimulus packages. While the business cycle survey does depict an improvement in order books and building price expectations in February, companies assume that employment will remain weak in the months ahead.

In the first half of the 2009-10 winter season, tourism sales remained 3 percent below last year's record level, according to preliminary calculations. The number of overnight stays fell by 2 percent over the same period.

The repercussions of the financial and economic crisis thus hit Austria's tourism sector less severely than expected. The relatively favourable result by international standards may have been largely due to the strength it derives from its proximity to markets: Guests from important source countries as well as resident travellers chose a stay in nearby Austria over long-haul trips with sometimes uncertain product quality.

While the demand from foreign travellers, at -3.5 percent, declined markedly from November 2009 to January 2010, overnight stays by resident guests posted an increase of a similar magnitude (+3.6 percent). Among the major foreign source markets, positive developments were registered notably in the demand from Italy (+6.4 percent), Russia (+5.2 percent), Belgium (+2.3 percent) and France (+2.2 percent), whereas the demand fell in all the other markets of importance for Austria.

The situation in Austria's labour market remained unchanged in the first two months of 2010. The seasonally adjusted number of persons in active dependent employment rose by 0.1 percent month-on-month in each of the two months, according to first estimates.

But at the same time the seasonally adjusted number of unemployed persons also rose again by 1.0 percent month-on-month in February. This may have been partly due to the cold winter weather. Overall, 312,900 people were registered as unemployed in February, an increase by 11,200 (3.7 percent) from a year before. 83,400 people were enrolled in training programmes, 25,400 (44 percent) more than in the previous year.

The seasonally adjusted unemployment rate stood at 7.5 percent in February, according to the Austrian method of calculation, by 0.8 percentage points higher compared to a year earlier. The number of vacancies hardly declined any more in February (-0.2 percent).

In January, the inflation rate (as measured by the Consumer Price Index) stood at 1.2 percent. The harmonised inflation rate (HICP) was also 1.2 percent, thus slightly above the euro area average (1.0 percent).

As mentioned above, the rise in CPI inflation in recent months has been largely driven by energy price developments. In January, the price index of the expenditure category "Transport" was up by 3.7 percent from a year earlier. The positive contribution from energy prices to the inflation rate is expected to fade towards the middle of the year, however.

CPI inflation excluding energy and unprocessed food came in at 1.1 percent in January. It has thus been declining steadily from the peak of 2.9 percent in September 2008.

### Sentiment improving modestly in industry and the services sector

### Winter tourism down from last year's record level

*For the tourism industry, the winter season so far has been weaker than last year's.*

### Labour market situation unchanged

### Inflationary pressures remain weak

*The rise in the inflation rate since September 2009 can be attributed mainly to the year-on-year increase in the price of crude oil. Inflation excluding energy and food continues to ease.*



Wholesale prices are beginning to recover, following their sharp decline in 2009 due to weak demand. In January, the wholesale price index for the first time again exceeded its level a year earlier.

### *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, this is referred to as "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.

#### *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/>).

#### *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".