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Economy Remains Tepid

Business Cycle Report of August 2013

Economic activity in Austria remains subdued. The export-driven manufacturing sector suffers from persistently weak demand in the euro area. Trade and tourism have lately registered a decline in sales. Leading indicators point to a tentative improvement in Austria. In the EU, too, economic activity is strengthening only slowly.

For definitions of terms used, see "Methodological Notes and Short Glossary", <http://www.wifo.ac.at/wwadocs/form/WIFO-BusinessCycleInformation-Glossary.pdf> • All staff members of the Austrian Institute of Economic Research contribute to the Business Cycle Report. • Data processing: Christine Kaufmann, Martha Steiner • Cut-off date: 8 August 2013. • E-mail address: Sandra.Bilek-Steindl@wifo.ac.at

World trade continues to expand at a stable pace. Export activity has recently improved notably in the industrialised countries, while it has lost momentum in Asia's emerging market economies. China saw economic growth weaken yet again in the second quarter, owing to both cyclical and structural factors.

By contrast, GDP grew at a robust pace in the USA (second quarter +0.4 percent quarter-on-quarter, after +0.3 percent in the first quarter). Increased consumption and investment stimulated the economy. In the EU countries, by contrast, economic activity has remained tepid recently. Industrial production, which had grown steadily since February, declined again on EU average and in Germany, according to most recent data. Nevertheless, leading indicators suggest a pick-up in economic activity in the coming months: the European Commission's Economic Sentiment Indicator shows that both consumers and companies have become more optimistic about the future outlook.

The dampening impact of the unfavourable international environment on Austrian exports and industrial activity appears to be waning already. Cumulated exports from January to April 2013 already exceeded the year-earlier level. Evidence presented in WIFO's latest Business Cycle Survey points to a further, albeit only slow recovery of the manufacturing sector: both the assessment of the current situation and business expectations remain predominantly sceptical, although the trend has slightly improved of late. Sentiment in the construction sector also remains subdued.

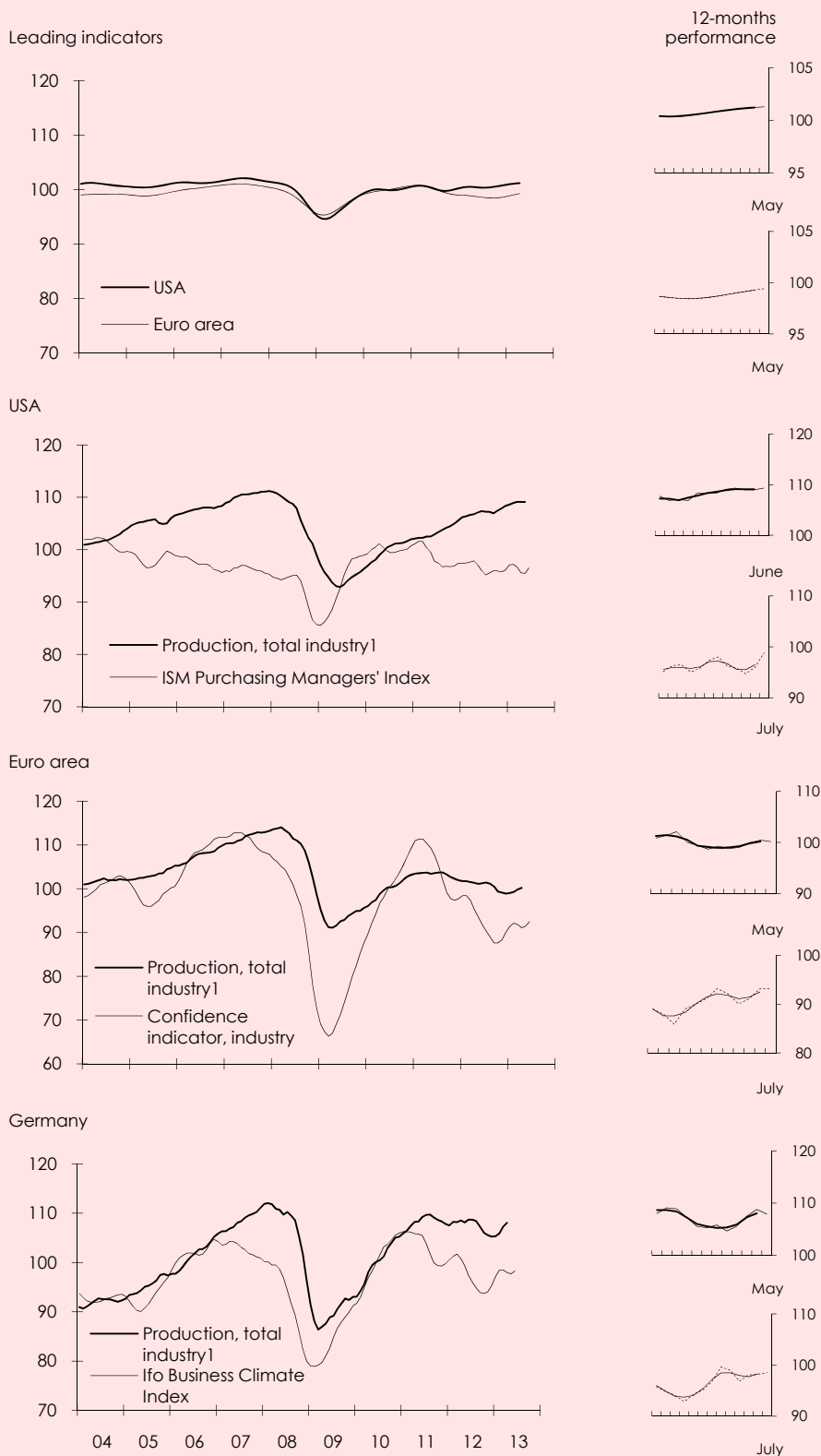
Tourism sales (nominal and real) from May to June 2013 remained below the year-earlier level. The weak development is also due to the fact that guests are becoming increasingly savings-minded, which is reflected in a drop in real expenditure per night spent.

Inflation stood at 2.2 percent in June (after 2.3 percent in May). Since the beginning of 2011, inflationary pressures have been largely driven by price increases in the food, housing, water and energy, and services categories.

The economic weakness continues to weigh on the labour market. In July, the number of persons registered as unemployed exceeded the year-earlier level by 12.6 percent, with the strongest increases recorded in construction and manufacturing. Compared with the previous month, the seasonally adjusted number of unemployed persons increased by 2.1 percent in July. The seasonally adjusted unemployment rate stood at 7.8 percent in July (according to the Austrian method of calculation).

Figure 1: International business climate

Seasonally adjusted, 2010 = 100, 3-month moving average



Source: European Commission, Deutsche Bundesbank, ISM (Institute for Supply ManagementTM), Ifo (Institute for Economic Research, Munich), OECD. - ¹ Excluding construction.

World trade continues to stabilise. In May, the three-month moving average was up 0.8 percent from the previous period. Unlike in the preceding months, growth was not driven solely by emerging market economies: Recently, the industrialised coun-

Global trade stabilising

tries (here above all Japan, and to a lesser extent the euro area) have also registered an increase in exports, while in May exports of Asia's emerging market economies (three-month moving averages) remained below the levels recorded in the previous period; Latin America, by contrast, has registered a marked increase. Industrial production has expanded similarly on a geographically broader basis recently.

China's economy has been cooling already since the beginning of 2013. In the second quarter, GDP rose at a seasonally adjusted quarter-on-quarter rate of 1.7 percent (after +1.6 percent in the first quarter) – in 2011 and 2012, the average growth rate had still exceeded 2 percent. The Manufacturing Purchasing Managers' Index (according to HSBC) and the OECD's Composite Leading Indicators declined in June, an indication that this trend persists. At the same time industrial production, at +8.9 percent in June grew at a slower pace than in the two preceding months. This development can be attributed not only to the weakness of the global economy, but also to structural factors such as for instance an increased shifting away of the structure of the economy from the industrial towards the services sector. Notwithstanding a stronger orientation towards sustainability and qualitative objectives (income distribution, reduction of excess capacity), the government is still implementing expansionary measures so as to prevent developments from falling too far behind the desired growth path. Apart from supporting the export industry, increased measures are now being taken to stimulate domestic demand.

Japan's economic policy is also pursuing strongly expansionary objectives. Both infrastructure projects and an easing of monetary policy are aimed at strengthening the economy and fighting deflationary trends. Following a marked expansion of the economy in the first quarter of 2013 (+1 percent, quarter-on-quarter), the Tankan leading indicators released by Japan's central bank suggest a continuation of the upward trend. Exports are benefiting from the depreciation of the yen; they expanded for the fourth consecutive time in June.

According to the first advance estimate, GDP in the USA increased at a quarter-on-quarter rate of 0.4 percent in the second quarter (after +0.3 percent in the first quarter). The recovery is largely attributable to the improved domestic economic situation, with the main contribution to growth coming from personal consumption expenditure and fixed investment. Industrial activity has also been robust of late. Following stagnation in May, industrial production expanded at a month-on-month rate of 0.3 percent in June. Capacity utilisation has again increased somewhat recently, but at 77.8 percent in June still remained below its long-term average (1972-2012: 80.2 percent).

Companies are much more optimistic about the prospects for the coming months, according to most recent survey data. In July, the Purchasing Managers' Index (PMI) rose markedly to 55 points (from 51 points in June 2013), its highest level in two years. Consumer sentiment has also been following a steady positive trend. According to the Conference Board, consumer confidence did fall slightly in July, but since June 2013 has again been at the level recorded in 2008. Household wealth is also benefiting from the recovery of the real estate market. The S&P/Case-Shiller Index has been rising already since February 2012.

Economic activity in the EU as a whole and in the euro area is only slowly gaining strength. Industrial production, after increasing on a month-on-month basis from February to April, weakened slightly in May. However, leading indicators point to a pick-up in the third quarter. In July, the Purchasing Managers' Index for the euro area (according to markit) for the first time since the beginning of 2012 again posted above the 50.0 mark, the expansion/contraction threshold. The European Commission's Economic Sentiment Indicator continued its upward trend in July, signalling that economic activity in the euro area and in the EU as a whole is slowly recovering. This recovery extends to almost all sectors (manufacturing, services, trade, and private consumption). As in recent months, consumer confidence also improved, and pessimism about future labour market conditions waned, although unemploy-

World trade continues to expand at a slow pace; recently, the industrialised countries have taken on a bigger role in driving growth.

US growth path pointing upward

In the USA, growth was robust in the second quarter. Survey data point to a sustained recovery.

Confidence growing in Europe

Following an interruption of production growth in the EU and the euro area in May, leading indicators suggest that consumption and industrial activity will pick up in the current quarter.

ment remains high in some countries. The seasonally adjusted unemployment rate averaged 11.0 percent in the EU in May 2013. It had risen markedly in the course of the year; a year before, it had stood at 10.5 percent. A strong increase from already high levels was recorded in Spain (June 2013: 26.3 percent, June 2012: 25.1 percent), Greece (April 2013: 26.9 percent, April 2012: 23.1 percent) and Portugal (June 2013: 17.4 percent, June 2012: 15.8 percent). Youth unemployment levels remain alarmingly high: In May 2013, the youth unemployment rate stood at 23.4 percent in the EU as a whole, and at 23.9 percent in the euro area.

Following a downward trend observed since the autumn of last year, price growth again began to accelerate modestly in May. In June, inflation in the euro area came in at 1.6 percent. The sub-indices having the largest upward impacts on headline inflation were fruit and vegetables, hotels, restaurants and cafeterias, and electricity. The lowest inflation rates were observed in Greece (-0.3 percent) as well as in Latvia and Poland (0.2 percent each), the highest in Estonia (4.1 percent).

The HWWI Index of World Market Prices of Commodities, which comprises food, alcoholic beverages and tobacco as well as energy and industrial raw materials, in dollar terms rose by 5.1 percent year-on-year in July. In euro terms, the index stood 1.3 percent below its year-earlier level, owing to the appreciation of the euro against the dollar. The decline in the prices of food, alcoholic beverages and tobacco as well as industrial raw materials found a counterpart in a small increase in crude oil prices. In July, the price of Brent crude oil averaged \$ 107.9 per barrel (+5.2 percent, compared with a year before). The euro-dollar exchange rate has remained broadly stable lately (July 2013: 1.31 \$ per €, June 2013: 1.32 \$ per €), exceeding the year-earlier level by 6.4 percent.

Industrial activity in Germany is strengthening somewhat, even though it slowed slightly in May. The Industrial Production Index, after rising steadily for several months, fell in May compared with the previous month. Especially foreign sales shrank. This development is also reflected in the seasonally adjusted contraction in exports in May compared with April. Cumulated exports (from January to May) were down 0.3 percent from their year-earlier level. Strong demand from China stabilised exports against the background of weak economic activity in Europe. While exports to the EU in the first five months of the year (cumulated) declined, those to third countries increased by 2.2 percent.

Leading indicators suggest that activity in Germany is gaining momentum. German companies are optimistic about the future; the Ifo Business Climate Index rose for the third consecutive time in June.

The retail sector, by contrast, has remained little dynamic lately. Both nominal and real sales (seasonally adjusted) declined in June compared with the previous month.

Economic activity in Austria is also subdued. The weakness observed in the euro area dampens activity in the export-driven industrial sector, although it is assumed to have passed its nadir. Cumulated exports from January to April already exceeded the year-earlier level by 1.7 percent, while exports in April posted year-on-year growth of 8.5 percent, according to Austria's foreign trade statistics. Displaying a similar trend as in Germany, the value of exports to the EU in the first four months of 2013 fell by 0.3 percent from a year before, whereas deliveries to third countries exceeded those in 2012 by 6.3 percent.

Industrial activity is also slowly recovering. The production index has stabilised in recent months, although a renewed decline was observed in May compared with the previous month. Evidence presented in WIFO's recent Business Cycle Survey points to a moderate recovery: Both the assessment of the present situation and business expectations are predominantly sceptical but slightly trending upwards. Sentiment in the construction sector is also muted; while companies state that the present situa-

Low inflation dynamics in euro area and in commodity markets

German economy recovering only slowly

Persistently weak demand at home and abroad weighs on economic activity in Germany.

Austria: business expectations muted

Leading indicators have improved only little in Austria recently; companies expect the economic situation to remain tense.

tion has somewhat improved, they are more cautious in their assessment of developments in the coming months.

WIFO's Leading Indicator also barely suggests any changes in the outlook for economic activity. Stagnation has already persisted since March. The international components of WIFO's Leading Indicator did improve in July compared with the previous month, but the Austrian components deteriorated.

Figure 2: 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.

Measured by the European Commission's Consumer Confidence Indicator, consumer confidence continued to weaken considerably in July. This was largely due to the sizeable deterioration in consumers' appraisals of job prospects and in their savings expectations for the coming 12 months. Consumers were also grimmer about the future general economic situation than they had been in June. The weak consumer sentiment and the related reluctance to spend – primarily on consumer goods – are also reflected in the decline in new passenger car registrations for private households (January to June almost -14 percent, compared with the previous year).

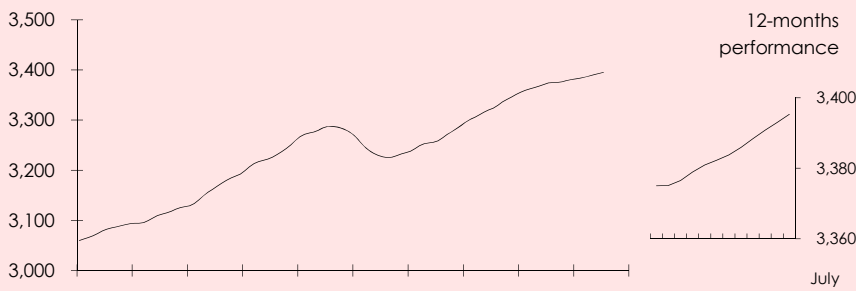
Following an extremely weak first quarter with sharp falls in both nominal and real sales, total trade sales declined at a slower pace on average in April and May (working day adjusted, according to Statistics Austria). In April and May, nominal and real retail sales exceeded the year-earlier levels, while in June they fell below those levels, according to provisional data released by Statistics Austria.

Persistently weak consumer confidence

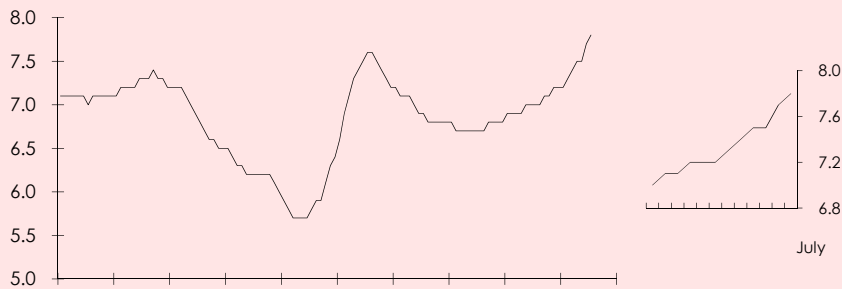
Households remain reluctant to purchase consumer goods. New passenger car registrations declined once again in June.

Figure 3: Key economic indicators

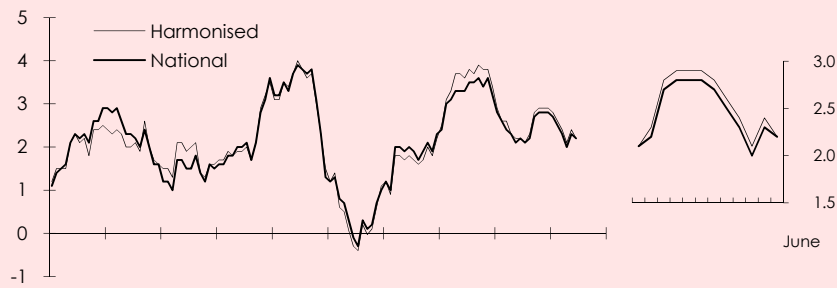
Persons in active dependent employment¹, (1,000), seasonally adjusted



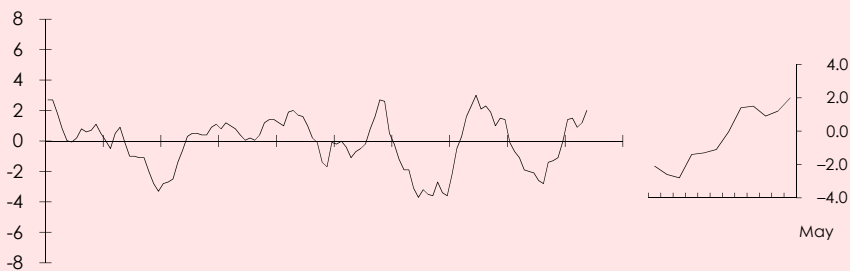
Unemployment rate, traditional Austrian method², seasonally adjusted



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, Federation of Austrian Social Security Institutions, Oesterreichische Nationalbank, Statistics Austria, WIFO calculations. – ¹ Excluding parental leave, military service, and unemployed persons in training. – ² As a percentage of total labour force excluding self employed, according to Public Employment Service.

Tourism sales fell slightly in May and June 2013 (–0.6 percent, year-on-year), according to provisional calculations. Adjusted for price changes, however, the decline was substantial (–2.7 percent). Real expenditure per night spent also dropped noticeably (–1.7 percent). This development can be attributed to the fact that guests have become savings-minded, which is evidenced by, among other things, the substantial increase in the number of nights spent in commercial holiday apartments or private holiday homes and apartments allowing holidaymakers to save money through self-catering. In the first two months of the 2013 summer season, for instance, the number of nights spent in commercial holiday apartments rose by 4.1 percent, while that of overnight stays in private holiday homes and apartments remained broadly flat (–0.3 percent). All the other accommodation establishments posted a decline (–1.3 percent), however.

The total number of overnight stays fell by 1.0 percent from the very high level recorded in 2012. The demand from foreign travellers was almost unchanged from last year (–0.4 percent), whereas that from domestic guests, at –2.2 percent was clearly weaker. The development in June was particularly unfavourable, owing to the weather and the timing of the holidays.

The inflation rate fell to 2.2 percent in June (May 2.3 percent). Overall, inflation in June was again largely driven by price increases in the food as well as in the housing, water and energy categories. The cost of electrical power (kilowatt-hour rate per day) rose by 6.4 percent from a year before, while maintenance costs of rental apartments increased by 4 percent. Mineral oil products, by contrast, cost less compared with a year before. The price of four-star petrol declined by 1.6 percent, that of diesel fuel by 1.1 percent year-on-year.

The Harmonised Index of Consumer Prices (HICP) also increased at a rate of 2.2 percent and once again exceeded the euro-area average (1.6 percent). The inflation differential vis-à-vis the euro area (and Germany) has been positive again since autumn 2012, and from November to May averaged 0.8 percentage point (0.9 percentage point vis-à-vis Germany). This development is attributable to the considerably sharper increase in the cost of services seen in Austria (restaurants and cafeterias, housing, communication and medical services: Austria +3.4 percent, euro area +1.6 percent, Germany +1.4 percent). In June, the inflation differential shrank to 0.6 percentage point vis-à-vis the euro area, and to 0.3 percentage point vis-à-vis Germany.

Growth in the number of persons in dependent active employment decelerated in July, according to provisional calculations (+0.5 percent, compared with the previous month), after having still reached 0.7 percent on average in the first six months of the year. On a month-on-month basis, it has been decelerating already since March 2012. The number of job vacancies registered with the Public Employment Service declined further (–3,800, compared with a year before). At the same time the number of unemployed persons increased once again: In July, 256,500 persons were registered as unemployed, an increase by 28,600 from July last year. The number of persons enrolled in training courses also continues to grow. In July, 34,400 more people were without a job than a year earlier. Especially construction and manufacturing recorded a marked increase in the number of unemployed persons.

The unemployment rate was 6.7 percent in July, according to the Austrian method of calculation, an increase by 0.7 percentage point compared with the same month a year before. The seasonally adjusted rate was 7.8 percent.

Tourism sees sales decline

The uncertainty about the future economic situation is reflected in tourists' holiday behaviour. Expenditure per night spent is declining, and there is greater demand for less expensive accommodation.

Inflation steady

Unemployment Continues to rise