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# Economic Revival in the EU and in Austria Remains in Low Gear

## Business Cycle Report of May 2010

**The global economy continues to recover, driven mainly by the USA and emerging Asia and Latin America. The US economy expanded at a rate of 0.8 percent in the first quarter, consumption and equipment investment remained robust. In the EU and in Austria, economic activity was subdued in the first quarter. While in Austria the construction sector suffered weather-related production losses, retail trade exerted a stabilising effect. The Austrian labour market is slowly beginning to stabilise.**

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The global economic recovery continues, with notably the emerging economies of Asia and Latin America as well as the USA again recording brisk value added growth in the first quarter. US GDP expanded at a quarter-on-quarter rate of 0.8 percent in the first quarter. Nevertheless, labour market conditions are improving only very slowly. Seasonally adjusted unemployment stood at 9.7 percent for the third consecutive month in March.

The global financial system, while having gained stability since the autumn of 2009, is still regarded as fragile. The high debt levels of some euro area countries have become an additional burden for Europe's financial markets.

Confidence indicators improved steadily in the EU and the euro area. Value added grew only moderately in the first quarter, though (+0.2 percent, quarter-on-quarter). Notably the construction industry in some countries suffered production losses owing to the cold winter. But at the same time the situation in the industrial sector eased somewhat. Leading indicators point towards a stronger pickup in economic activity in the second quarter.

Austria's economy stagnated in the first quarter. Evidence from WIFO's latest business cycle survey signals a strengthening of manufacturing activity in the second quarter, following the moderate performance of this sector at the beginning of the year. Industrial capacity utilisation stood at 79 percent in April, an improvement by 3 percentage points compared with the beginning of 2010. As regards firms' assessment of future developments, positive expectations meanwhile also outweigh negative expectations; hence the expansion of production is likely to continue. In the construction sector, where activity has so far been little dynamic, order book levels are stagnating at a medium level.

Trade and tourism activity was more lively at the beginning of the year. Retailers and motor vehicle dealers posted good results, also because car sales had been particularly low a year earlier before the introduction of the scrappage premium in April 2009. Due to the early timing of Easter, the tourism sector recorded an increase in overnight stays during the winter season.

Foreign trade is also slowly stabilising as the global economy recovers. In January, exports were down by just 2.7 percent from a year earlier, following an average decline of 22.7 percent from January to October 2009.

Inflation in Austria accelerated to 2 percent in March (up from 1 percent in February). This surge is mainly attributable to the development of energy prices, which have been rising again steadily since the end of 2009.

Table 1: Flash estimates of quarterly national accounts

	2008 Fourth quarter	2009 First quarter	2009 Second quarter	2009 Third quarter	2009 Fourth quarter	2010 First quarter
Adjusted for seasonal and working day effects, percentage changes from previous quarter, volume						
<i>GDP, expenditure approach</i>						
Final consumption expenditure						
Households <sup>1</sup>	+0.1	+0.2	+0.3	+0.3	+0.3	+0.3
General government	+1.5	-1.5	+0.3	+1.6	+0.1	+1.0
Gross capital formation	-3.2	-3.0	-3.3	-1.8	-1.3	-1.0
Gross fixed capital formation	-2.5	-2.7	-1.7	-0.8	-1.9	-1.9
Exports	-6.2	-7.6	-3.0	+1.4	+1.2	-0.2
Imports	-4.7	-6.6	-3.1	+0.4	-0.0	-0.2
Gross domestic product	-1.2	-2.2	-0.5	+0.7	+0.3	+0.0
<i>GDP, output approach</i>						
Agriculture, forestry	-0.9	+0.6	-2.1	+1.2	-0.7	-1.6
Industry, including energy	-4.4	-5.2	-2.1	+1.7	+1.1	-0.3
Manufacturing	-5.0	-7.3	-1.6	+2.4	+1.0	-0.9
Construction	-0.9	-2.2	-1.4	-0.1	-0.4	-0.1
Wholesale and retail trade; repairs; hotels and restaurants; transport, communication	-1.3	-2.3	-0.4	+0.2	-0.2	-0.4
Financial intermediation; real es- tate, renting and business activities	-0.0	-1.1	-0.7	-0.1	-0.2	-0.0
Other service activities	+0.6	+0.4	+0.5	+0.6	+0.7	+0.7
Taxes on products	-0.8	-0.3	+0.6	+1.4	+0.9	+0.3
Subsidies on products	-1.1	-2.6	-1.6	-0.7	+0.3	+1.2
Percentage change from previous year						
Gross domestic product, volume	- 0.3	- 4.7	- 4.9	- 3.1	- 1.2	+ 0.4

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

Figure 1: Capacity utilisation in manufacturing industry

In percent



Source: European Commission, WIFO business cycle survey.

The stabilisation of economic activity is slowly feeding through into the labour market. In April, the number of persons in dependent active employment rose by 17,200, year-on-year. The number of persons registered as unemployed fell for the first time in March (-4,800 year-on-year) and continued to decline in April (-8,600 year-on-year); however, more unemployed persons were enrolled in training programmes also in April (+26.3 percent, compared with a year before). In April the seasonally

adjusted unemployment rate according to the Austrian method of calculation fell to 7.1 percent.

The global economy continues to walk the path of recovery, although according to the CPB Trade Monitor, world trade no longer expanded as vigorously in January and February as it did at the end of 2009. Activity is vibrant notably in Asia and in Latin American emerging economies. The first quarter saw China's economy expand at a double-digit year-on-year rate again, the first such increase since the first half of 2008. Domestic demand rose once more, thanks to the government's economic stimulus programmes, and in March China's imports outpaced exports for the first time in six years.

In Brazil, too, the economy is being stimulated by rising raw material exports, but increasingly also by the pickup in domestic demand. Growing consumption orientation in emerging market economies is exerting a positive effect on the demand for imports. However, rising private household demand and the strong expansion of infrastructure investment credits are adding to the risk – notably in China – of a real estate bubble. Besides, inflation is already accelerating in China and India.

The recovery in Japan is largely driven by net exports. Japan's economy currently benefits from the strong growth of Asia's emerging economies and strengthening demand in the USA. In March, exports rose by 44 percent year-on-year, following a decline of a similar magnitude the year before. In 2009, Japan's GDP shrank by 5.2 percent, owing to the country's high dependence on exports.

The global financial system, while having gained stability since the autumn of 2009, is still being regarded as fragile. Notably the high levels of government debt of some euro area countries have recently been reflected in European bond and stock market fluctuations and have caused the euro to depreciate. The IMF's current risk map, which provides a summary of a multitude of financial market indicators, points to a gradual stabilisation of the financial system: With liquidity in financial markets having increased and the risk to important financial services companies of loan and valuation losses rated as lower in autumn 2009 and spring 2010 than a year earlier, investor confidence has also begun to slowly strengthen. The risk connected with investment in emerging economies is currently also rated as lower than last year.

Following their fall in the first half of 2009, prices of crude oil and other commodities have been rising again steadily since the end of last year on the back of increasing demand for raw materials from Asia. Brent crude oil prices averaged \$ 84.64 per barrel in April, as compared with around \$ 50 in April 2009. The HWWI Index of World Market Prices of Commodities, which comprises food as well as energy and industrial raw materials, posted an increase averaging 58 percent (in dollar terms) in the first quarter, compared with the same period a year earlier. Commodity market developments are influenced not only by supply and demand, but also by speculation.

Following brisk growth in the fourth quarter of 2009 (+1.4 percent), the US economy expanded at a vigorous pace also in the first quarter of 2010. GDP rose at a quarter-on-quarter rate of 0.8 percent, with private household consumption expenditure once again contributing considerably to growth. Investment in equipment also increased appreciably, whereas residential investment contracted again for the first time since the second quarter of 2009. The real estate market correction may be over for now for residential properties; commercial properties, by contrast, continue to lose further in value due to low utilisation rates.

Leading indicators signal a continuing revival of the economy also in the second quarter of 2010. The ISM Purchasing Managers' Index was in excess of 50 percent for the ninth consecutive month in April, indicating further expansion of business activity in the industrial sector. Consumer sentiment also brightened further, reflected in a marked rise in the Conference Board's index in April.

## Global economy recovers – risks in financial markets persist

*Vibrant activity in emerging market economies continues to drive the recovery of the global economy, even though it moderated slightly at the beginning of the year. While global financial stability has increased since the autumn of 2009, the huge debts of some European countries are putting additional strain on the markets.*

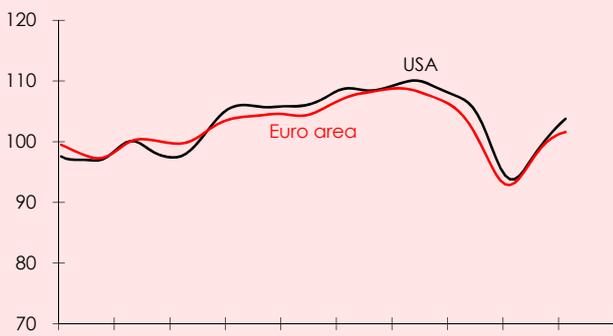
## USA sees expansion continue

*The US economy expanded at only a slightly slower pace in the first quarter. Equipment investment and consumption have remained highly dynamic.*

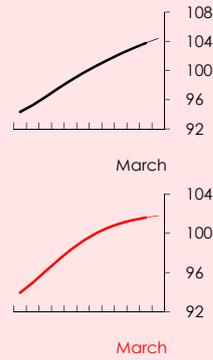
Figure 2: International business climate

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

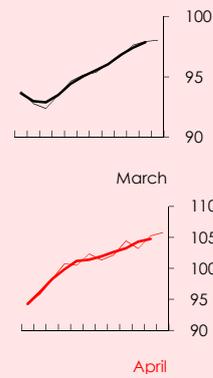
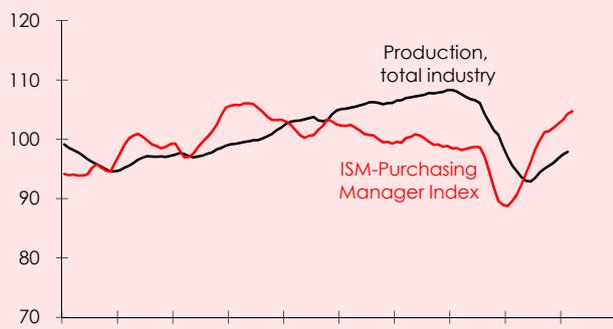
Leading indicators



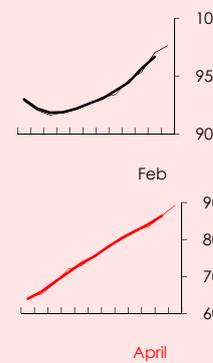
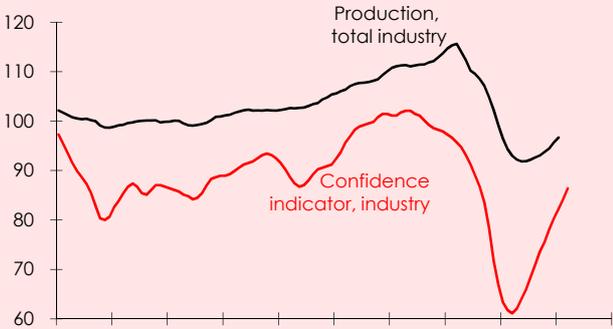
12-month performance



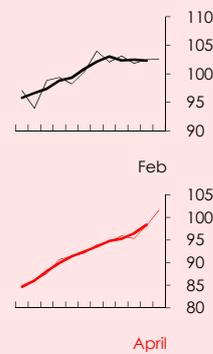
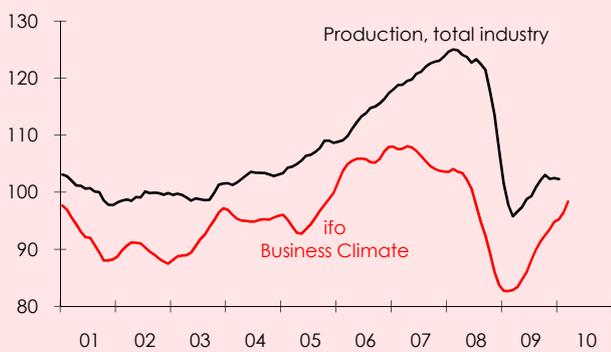
USA



Euro area



Germany



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

By contrast, labour market conditions are improving only slowly. The seasonally adjusted unemployment rate stood at 9.7 percent for the third consecutive month in March. It may have reached its peak in autumn 2009 (October 2009 10.1 percent). The rebound is also being dampened by structural changes. The number of people unemployed long-term is growing steadily; in March 2010, around 44 percent of those unemployed had already been without a job for at least 27 weeks.

Inflation in the USA edged slightly higher again at the start of the year (March +2.3 percent), reflecting rising commodity prices.

Industrial production in the EU as a whole and in the euro area expanded on a month-on-month basis also in January and February. The seasonally adjusted figures, after declining since May 2008, have been rising again steadily since mid-2009. Since the beginning of the year production has now for the first time been exceeding the year-earlier level. Economic activity was nevertheless subdued in the first quarter of 2010.

Following stagnation in the fourth quarter of 2009, the euro area economy expanded moderately in the first quarter of 2010 (+0.2 percent). Weather effects also played a role here, apart from persistent purchase and investment restraint as well as the high exchange rate of the euro at the end of 2009. However, leading indicators signal that economic activity will gather momentum in the second quarter. The European Commission's latest business survey shows a further rise in confidence and order book levels in the industrial sector. Industrial activity is being shored up notably by strengthening demand from the USA and Asia. The depreciation of the euro also has a positive effect on companies' export prospects.

The euro depreciated against the dollar from \$ 1.44 at the beginning of the year to \$ 1.33 at the end of April, but even so the exchange rate was still clearly higher than the average of the last ten years. The recent depreciation was preceded by a loss in confidence owing to the huge public debts of some euro area countries: In Italy and Greece, government debt in 2009 increased to around 115 percent of GDP, compared to a euro area average of 79 percent. According to Eurostat, Ireland, Greece and Spain had a deficit-to-GDP ratio exceeding 10 percent in 2009. The public debt crisis in the euro area has intensified further. After Greek government bonds, risk premiums have recently increased also for Portuguese and Spanish bonds. Greece has passed a savings package aimed at reducing the deficit over the medium term.

The speed and extent of the pickup in economic activity vary considerably across EU countries. While Germany, France and Poland saw their economies recover already in mid-2009, other, more peripheral countries were still in recession in the fourth quarter of 2009. High unemployment and still-tight bank lending conditions are weighing on private consumption notably in some new EU countries.

The seasonally adjusted unemployment rate remains high (March 2010 EU 9.6 percent, euro area 10.0 percent). The countries with the highest rates in March were Latvia, Spain and Slovakia, those with the lowest the Netherlands, Austria and Luxembourg.

Euro area HICP inflation accelerated to 1.4 percent in March. The sharp rise stemmed mainly from price increases for energy. According to Eurostat's flash estimate, inflation moved up slightly to 1.5 percent in April.

Economic activity in Germany remained subdued also at the beginning of 2010. Notably the construction industry suffered a drop in sales owing to the snowy winter. But the industrial sector has continued to recover, albeit at a slightly slower pace recently. Domestic trade and exports also fared badly in the first quarter. The strong decline in seasonally adjusted exports in January was only partly made up for in February.

## Slow revival in EU, debt crisis in euro area

*The economic recovery in the EU as a whole and in the euro area remains slow. Speed and extent of the pickup in economic activity vary across the individual countries.*

## Germany: weak economic activity at beginning of the year

Possible catching-up effects in the construction industry as well as a strengthened momentum in the industrial sector are likely to accelerate economic activity in the second quarter. This is also suggested by the rise in industrial new orders observed in January and February.

The Ifo Business Climate Index improved again in April. Considerably more firms than in recent months were satisfied with the current business situation. They also assessed the outlook for the coming six months more optimistically than in March. Aside from the general economic rebound, firms' confidence may also be attributable to the current weakness of the euro.

Austria's economy stagnated in the first quarter. Here, too, the construction sector is likely to have posted production losses due to the weather – the seasonally adjusted production index fell both in January and February in month-on-month terms. It is difficult to judge at present to what extent these losses were made up for during the subsequent months; but, given the low utilisation rate, there is reason to expect a counter-movement in the second quarter. Manufacturing activity will gather momentum in the second quarter, according to evidence presented in the WIFO business cycle survey. The capacity utilisation rate, at 79 percent in April was 3 percentage points higher than in January 2010, but still below the average of the previous five years (81.3 percent). Manufacturers are for the most part optimistic overall regarding future developments, which points to a continued expansion of production.

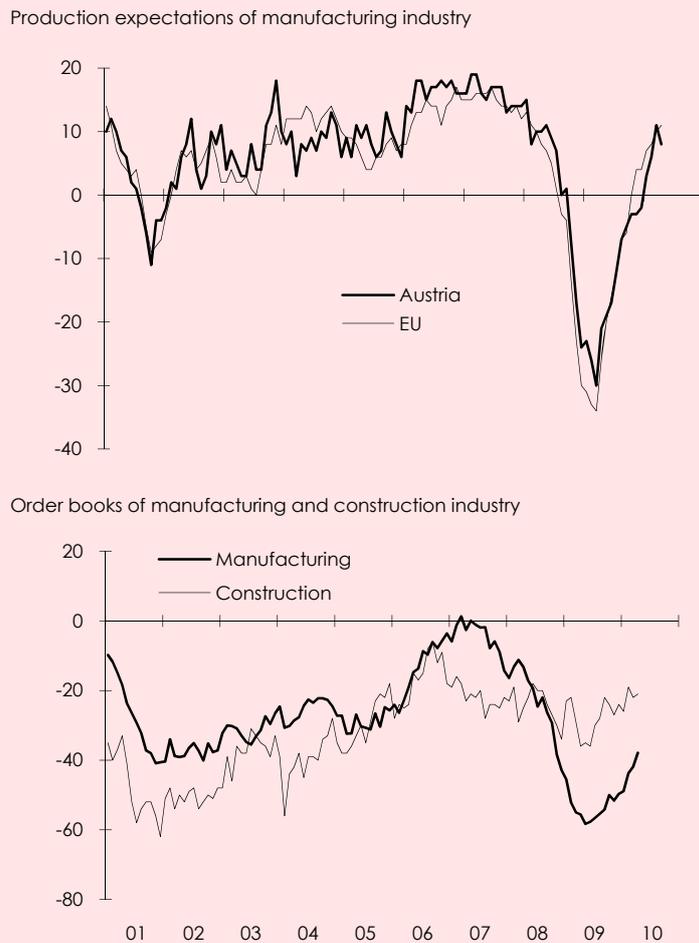
*Economic activity in Germany remained weak at the beginning of 2010, but leading indicators point towards a rebound in the second quarter.*

### Austrian export and industrial activity stabilising

*Industrial activity continues its steady recovery. Following moderate growth at the beginning of the year the pace of activity is expected to accelerate in the second quarter.*

Figure 3: WIFO business cycle survey

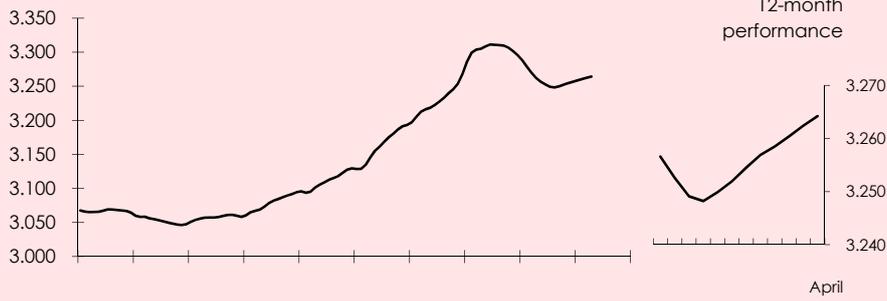
Differences between the percentage shares of correspondents giving positive and negative replies, seasonally adjusted



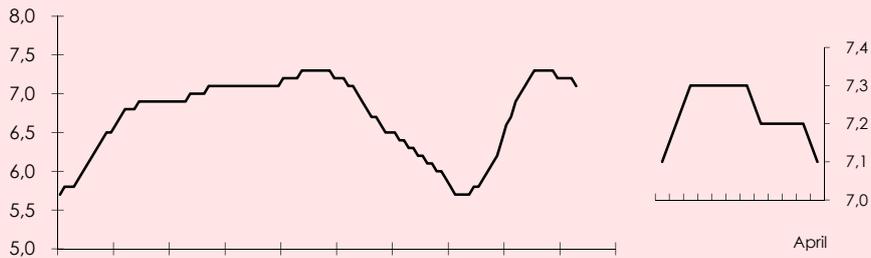
Source: European Commission, WIFO business cycle survey.

Figure 4: Key economic indicators

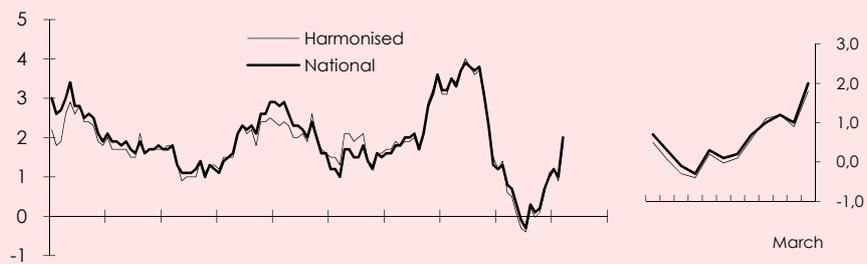
Persons in active dependent employment<sup>1</sup>, (1,000), seasonally adjusted



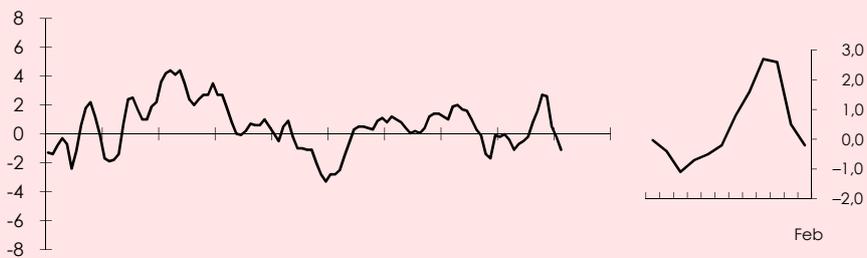
Unemployment rate, traditional Austrian method<sup>2</sup>, seasonally adjusted



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.

Foreign trade is also gradually recovering. While an upward trend has been apparent in seasonally adjusted figures already since mid-2009, first signs of a stabilisation are now emerging also in year-on-year figures. In January, exports fell by 2.7 percent, according to the Foreign Trade Statistics (January to October 2009 –22.7 percent on average). Developments of merchandise imports were similar (January –3.1 percent, year-on-year).

The breakdown by sales markets presents a varied picture: While exports to the EU as a whole (more than 70 percent of Austrian exports) still declined, cumulated exports to Germany from November to January were up by 3.3 percent compared with the same period a year before.

In the period from November 2009 to March 2010, tourism sales rose slightly to € 10,530 million (+0.7 percent, year-on-year), according to provisional calculations. The number of overnight stays overall increased by 1.3 percent.

The favourable result was largely due to the early timing of Easter (in 2010 the Holy Week fell in March, whereas last year it fell in April). The result to be expected at best for the winter season as a whole is a stagnation of sales, as a year-on-year decline is likely in April.

In the first five months of the 2009-10 winter season, especially overnight stays by resident guests increased markedly (+3.4 percent, foreign travellers +0.7 percent). A vigorous increase was recorded in the number of overnight stays by guests from Russia (+11.9 percent), Italy (+4.9 percent), Sweden (+3.5 percent), Switzerland (+3.4 percent) and Germany (+2.4 percent). While the number of nights spent by guests from the Czech Republic remained more or less unchanged from a year before (–0.6 percent), a decline was posted for those by travellers from the Netherlands (–1.8 percent), the USA (–2.8 percent), Hungary (–3.0 percent) and Poland (–3.5 percent). The demand from Romania (–12.6 percent) and Great Britain (–8.5 percent), on the other hand, collapsed.

Retailers posted good results early in the year. In the first quarter, real sales rose by 3.1 percent year-on-year. The early timing of Easter may have played a role here too. Motor vehicle dealers also reported sales increases. In the first quarter, new car registrations exceeded the year-earlier level, which had been depressed by the announcement of the introduction of the scrappage premium in April 2009, by as much as 18.3 percent. In April 2010, registrations then remained 11.4 percent below the high level recorded one year earlier. Activity in the wholesale sector was still subdued at the beginning of 2010, as both investment and foreign trade have been gaining momentum only slowly.

Inflation surged to 2 percent in March (January 1.2 percent, February 1 percent), the highest rate since November 2008. The Harmonised Index of Consumer Prices (HICP), at 1.8 percent slightly exceeded the euro area average (1.4 percent). As in the euro area overall, the acceleration of inflation in Austria was due mainly to price increases for energy since the end of 2009.

Inflation excluding energy stood at 1.2 percent in Austria in March. Fuel prices were up by around 20 percent from a year earlier; in February the price increase had still been around 10 percent. Household energy expenditure also rose more strongly than in February, although while heating oil prices increased (+30 percent; February +15 percent), gas prices typically declined. Gas prices lag almost one year behind crude oil price developments.

The wholesale price index, which is generally more volatile than the CPI, also rose markedly in March (+3.1 percent, February +1.2 percent), again mainly as a result of price increases for mineral oil products.

The stabilisation of the economy is slowly feeding through into the labour market. While the seasonally adjusted number of persons employed has already been rising slightly since mid-2009, the unadjusted figures have also been improving for the first

## Winter tourism demand up

*The early Easter date was reflected in an increase in overnight stays from November to March. While the number of nights spent by foreign guests was only slightly higher than a year before, overnight stays by resident guests increased again more strongly. Sales for the winter season as a whole are likely to have stagnated, however.*

## Retail business good, inflation accelerating sharply

*Both retailers and motor vehicle dealers reported sales increases in the first quarter. But the year-earlier level of motor vehicle sales had been relatively low as customers had exercised restraint in buying new cars before the introduction of the scrappage premium in April 2009. Inflation accelerated to 2 percent in March, largely on account of price increases for energy.*

## Labour market shows first signs of stabilising

time on a year-on-year basis since March 2010. The number of persons in dependent active employment rose by 17,200 in April. Since March 2010, firms have been adding jobs again (April +13.5 percent, year-on-year).

In April, 249,700 persons were registered as unemployed, a decline by 8,600 from a year before. At the same time more unemployed people were enrolled in training programmes offered by the AMS (Public Employment Service), and therefore were not included in the unemployment statistics (+16,900 compared with April 2009).

The seasonally adjusted unemployment rate according to the Austrian method of calculation stood at 7.1 percent in April (after 7.2 percent in March). According to the EU method of calculation, it was 4.9 percent in March.

### *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".