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Crisis of European Monetary Union Weakens Austrian Economy

Business Cycle Report of August 2012

The global economic environment continues to weaken. The crisis exerts major strain particularly on the economies in the euro area. The slowdown is also noticeable in Asia's emerging markets. These developments dampen economic activity in Austria. Growth in the manufacturing industry is slowing. But the construction and services sectors are still performing strongly. The situation in the labour market is deteriorating as a result of this development. Inflation remains low, though.

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The global economy continues to grow at a moderate pace, but signs of an economic downturn are mounting. This slowdown is largely a result of the crisis in the euro area and a deceleration of growth in emerging Asia. In the USA and in Latin America, by contrast, economic activity remains relatively robust.

In the euro area, economic activity is likely to decelerate further in the coming months. Uncertainty among private households and businesses is high, given the persistent crisis of confidence in public finances and the finance system of the European Monetary Union. This, in tandem with the drastic consolidation efforts launched by governments in many countries, is denting demand. Economic indicators suggest that several southern European countries will slide deeper into recession. In Germany, hitherto robust economic activity is also moderating somewhat. The economy in the euro area as a whole is likely to contract in the second and third quarters.

In Austria, economic activity remains robust. However, the weakening of the global environment caused by the crisis of the European Monetary Union also acts as a drag on developments in Austria. According to WIFO's Business Cycle Survey, growth in the – highly export-oriented – manufacturing sector will decelerate appreciably in the coming months. The construction and services sectors continue to do well, however, according to the assessment given by companies.

The situation in the labour market continues to deteriorate in Austria. The seasonally adjusted number of persons in dependent active employment has not increased further since April. Unemployment is on the rise again, with 228,000 persons registered as unemployed in July (+8.6 percent compared with a year earlier). The seasonally adjusted unemployment rate was 7.1 percent in July, according to the Austrian method of calculation, and 4.5 percent in June, according to Eurostat. The number of persons enrolled in vocational training programmes increased, that of vacancies decreased. Inflation remains low, however: the marked decline in commodity and energy prices since April 2012 has eased price pressures. Annual consumer price inflation stood at 2.2 percent in June. Hence, the rate of inflation in Austria is somewhat lower than the euro area average (2.4 percent).

The global economy continues to grow at a moderate pace. In May, world trade increased by 2.5 percent in real terms from the previous month (April -0.8 percent), according to CPB; the three-month moving average for the growth rate, which has greater informative value given the strong fluctuations of month-on-month changes, was 0.6 percent. The euro crisis is also clearly reflected in international trade, however: real merchandise imports of the euro area and Eastern Europe declined. Imports of the Asian emerging markets also expanded only moderately. Much brisker increases were registered in the USA, Japan and Latin America. Global industrial production, in month-on-month terms, increased by 0.5 percent in May, according to CPB, the same rate as the three-month moving average. World trade and industrial production expanded only significantly in the first five months of 2012.

In the USA, economic activity remains robust. In quarter-on-quarter terms, the economy expanded by 0.4 percent (first quarter +0.5 percent) in the second quarter. The largest contributors were household consumption and investment. Foreign trade, by contrast, acted as a drag on growth due to a vigorous acceleration of imports. The situation in the labour market remains tense, however: while at 8.3 percent, the seasonally adjusted unemployment rate in July was just under 1 percentage point lower than the rate recorded in July of last year, it has been roughly this high since the beginning of the year. The number of people employed rose by 163,000 month-on-month in July.

The leading economic indicators point to a further slowdown in economic activity in the latter half of this year. Following a noticeable decline since March, the ISM Purchasing Managers' Index came in just under the expansion-contraction threshold of 50¹ in July. Having previously deteriorated, the assessment of new industrial orders improved again moderately in May and June. Consumer surveys present a mixed picture: while the Consumer Sentiment Indicator continued to fall in July, the Consumer Confidence Indicator edged up again. According to both indicators, consumer confidence has dropped considerably since the beginning of 2012. The OECD Leading Indicator for the USA declined moderately in May.

Economic activity is slowing also in Asia. At +1.8 percent quarter-on-quarter, China's economy for the third time in a row expanded by less than 2 percent in the second quarter, albeit slightly more briskly again than in the first quarter (+1.6 percent). According to the National Bureau of Statistics of China, the Purchasing Managers' Index for the Chinese industry receded further in July, to just slightly above the 50-point threshold. In Japan, the central bank's Tankan Index for the business climate in manufacturing, though again edging up somewhat in the second quarter, remained negative. In Latin America, by contrast, economic activity has been robust of late; the OECD Leading Indicator for Brazil rose further in May.

In the EU, falling confidence in public finances and the financial system as well as the drastic consolidation programmes launched in many countries continue to act as a drag on the economy. So far the EU countries have not been able to put forth a comprehensive and credible plan for the solution of this crisis. The yields on government bonds of Ireland and most southern European countries remain so high that a long-term stabilisation of government debt appears difficult to achieve. Persistent uncertainty among private households and businesses acts as a further drag on demand.

Having contracted in the fourth quarter of 2011, the euro area economy failed to grow also in the first quarter of 2012. Several countries are in recession. Spain's gross domestic product declined by 0.4 percent in the second quarter, compared with the first quarter, according to provisional calculations (fourth quarter of 2011 and first quarter of 2012 -0.3 percent). In the UK, the economy also shrank by -0.7 percent compared with the previous quarter; this was the third consecutive decline, and a considerably brisker one than the one seen in the two previous quarters. By contrast,

Global economy continues to lose momentum

Signs of a further weakening of the global economy are mounting. The crisis of the European Monetary Union acts as a drag on global growth. A slowdown in economic activity is noticeable also in emerging Asia. In the USA and in Latin America, economic expansion remains robust.

Crisis of European Monetary Union continues

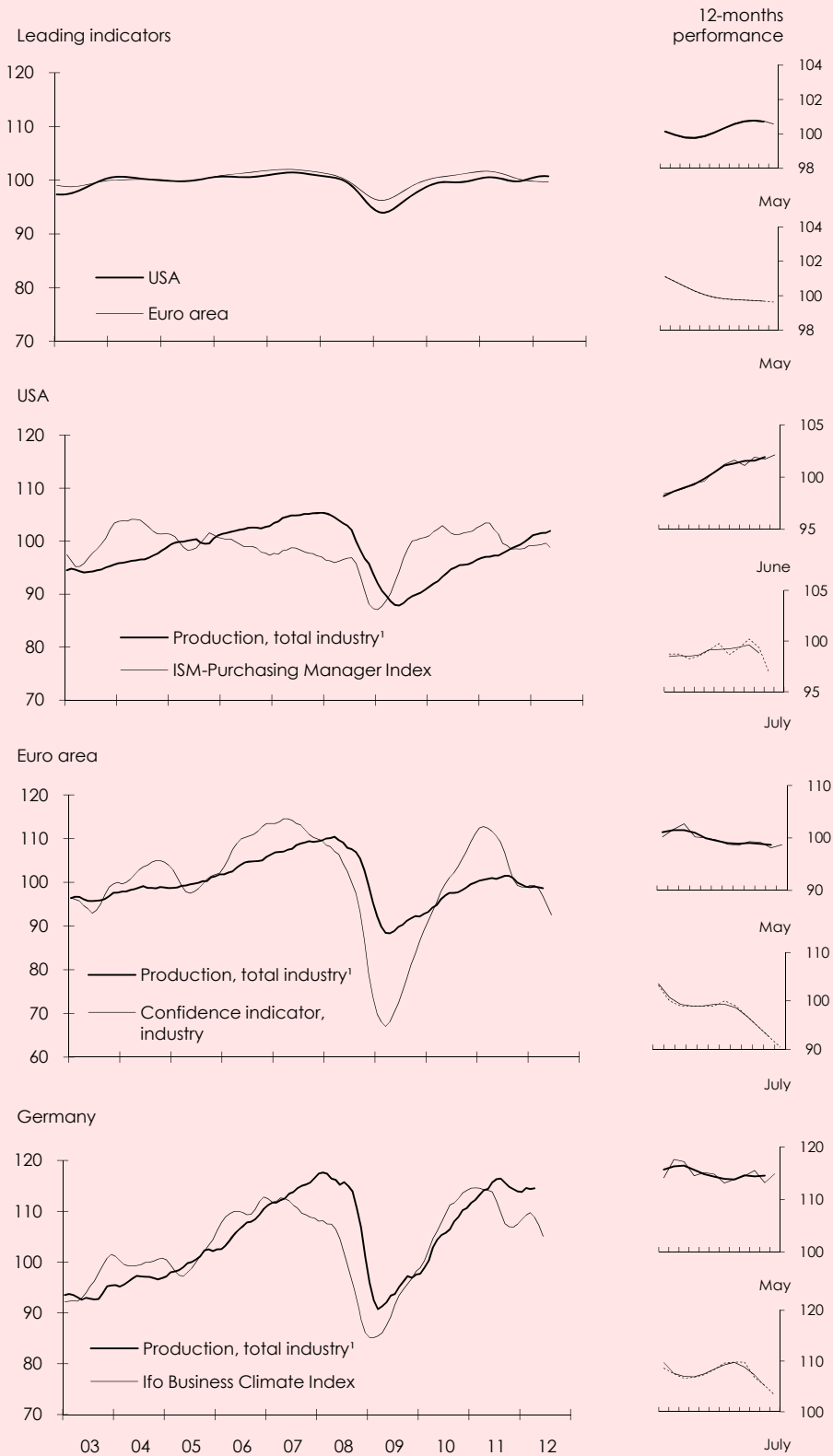
The uncertainty among private households and businesses triggered by the crisis of the Monetary Union, and the drastic consolidation measures by governments dent demand in the euro area. Economic indicators point to a decline in economic output in the second and third quarters of 2012.

¹ Readings above 50 indicate an expansion of the economy.

GDP still expanded at a relatively vigorous pace in Sweden, Poland, Finland, Slovakia and Germany in the first quarter (latest available data).

Figure 1: International business climate

Seasonally adjusted, 2005 = 100, 3-month moving average



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

The euro area economy is expected to contract further in the coming months. The indicators published in the European Commission's business survey of July are pointing downwards in the euro area as a whole and in most EU countries. Consumer and industrial confidence indicators fell further in the euro area. In April, manufacturing new orders also dropped; they have broadly stagnated since the beginning of the year. Industrial production also declined continuously from January to May 2012. Germany is also not left unscathed by this development: confidence indicators, new orders and industrial production declined in the last months for which data are available. In July, the Ifo Business Climate Index for the first time moved slightly into negative territory. According to the Euro Growth Indicator published by Euroframe, the euro area economy is set to contract in the second and third quarters.

Labour market conditions in the euro area are deteriorating rapidly. At 11.2 percent, the seasonally adjusted unemployment rate in June remained at the highest level recorded since the founding of the monetary union. The situation is particularly dramatic in Spain (24.8 percent) and Greece (latest reading: April 22.5 percent). In Ireland, Portugal and Slovakia, the unemployment rate was also considerably higher than the euro area average. It rose briskly in the last few months in Greece, Italy, Portugal and Spain, but fell markedly in Germany.

Inflation, by contrast, continues to ease. The Harmonised Index of Consumer Prices (HICP) rose by 2.4 percent in the euro area in June. Inflation was dampened in particular by the significant fall in commodity and energy prices. In June, crude oil prices (Brent) averaged \$ 95 per barrel, a decline by about \$ 30 from March. The HWWI Index of World Market Prices of Commodities excluding energy in dollar terms fell by almost 20 percent in the year to June. However, commodity and energy prices rose again in July, the price of crude oil averaged \$ 102. Core inflation (HICP excluding energy and unprocessed food) in the euro area stood at 1.8 percent in June, unchanged from a year before. In Greece, Ireland and Spain, inflation recently was below the ECB's target of 2 percent.

The weakening global environment continues to pose a major strain on the Austrian economy. According to WIFO's Business Cycle Survey, the index of manufacturers' assessment of their current business situation deteriorated for the fifth consecutive time in July. Negative assessments have been outnumbering positive ones already since May. But in July firms reported their production activity to be unchanged from the previous month. Order books and capacity utilisation still slightly exceed their long-term averages. According to the assessment given by companies, the outlook for the coming months continues to deteriorate. The business expectations index has been falling since March, and in July was clearly in negative territory. Firms gave a more pessimistic assessment both of their own business situation and of the situation of the economy as a whole.

In the construction sector, by contrast, activity continues to develop favourably. According to WIFO's Business Cycle Survey, the index of the assessment of the current situation improved somewhat in July, and was clearly in positive territory. Companies also continue to assess construction activity and order books positively. The index of business expectations deteriorated somewhat in July, however, but optimistic assessments still clearly outnumber pessimistic ones. In the services sector, the economic downturn is not yet noticeable either. Both the assessment of the current situation and business expectations are predominantly positive.

In May and June 2012, tourism sales exceeded the year-earlier level by 3.1 percent (+0.9 percent in real terms), according to provisional calculations. Real expenditure per night spent – an important quality indicator – fell by 2.2 percent. Thus the trend towards cheaper offers continued. The number of nights spent in the first two months of the 2012 summer season also increased compared with a year before (+3.3 percent). The demand for overnight stays from abroad rose by 4.9 percent, while, at +0.7 percent, the number of nights spent by resident travellers remained broadly flat.

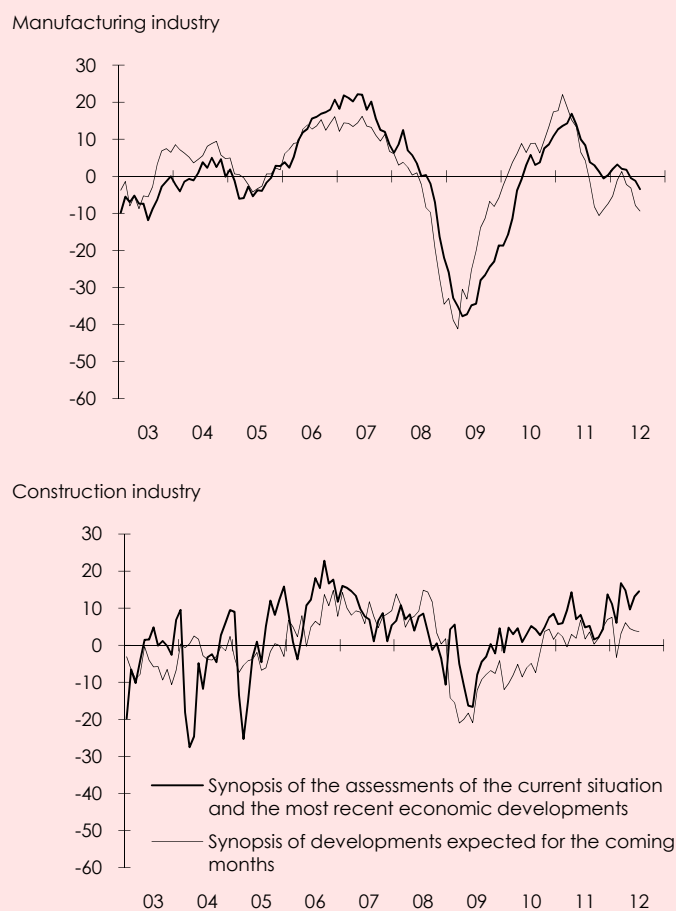
Austria's economy is slowing

The downturn of the global economy is weighing on the Austrian economy. Notably the manufacturing sector is set to experience markedly slower growth. Activity in the construction and services sectors remains robust. The situation in the labour market is deteriorating. Inflation remains low.

Number of overnight stays developing favourably

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.

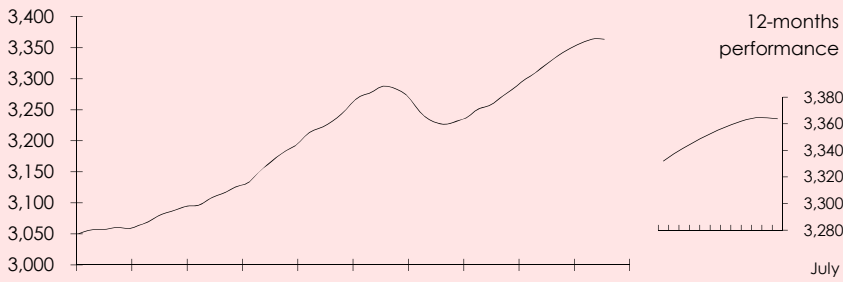
As regards the foreign source countries of importance for Austria, above-average increases were recorded over this period particularly in the number of overnight stays by guests from Russia (+22.5 percent), the USA (+9.3 percent), Switzerland (+8.9 percent), Hungary (+8.2 percent) and the Netherlands (+8.0 percent). Increases were also registered in the number of nights spent by guests from Denmark (+3.8 percent), Poland (+2.7 percent), Germany (+1.8 percent), the UK (+1.2 percent) and Sweden (+1.0 percent). While the demand from Belgium (+0.8 percent) and France (+0.5 percent) was broadly stable, the number of overnight stays by guests from the Czech Republic (-3.4 percent), Romania (-4.4 percent) and Italy (-8.2 percent) declined.

The situation in the Austrian labour market continues to deteriorate; employment growth has come to a standstill. The number of persons in dependent active employment increased by 40,000 in the year to July (+1.2 percent), according to an estimate by the Austrian Ministry of Social Affairs, but remained unchanged on a seasonally adjusted month-on-month basis. In July, 228,000 persons were registered as unemployed, an increase by 18,000 compared with a year earlier (+8.6 percent). On a seasonally adjusted month-on-month basis, the number of persons unemployed rose by 1.4 percent. The number of people enrolled in training programmes exceeded the year-earlier level by just fewer than 5,000. Job vacancies declined by 3,800. The seasonally adjusted unemployment rate rose marginally from the previous month (+0.1 percentage point), and stood at 7.1 percent in July, according to the Austrian method of calculation, or 4.5 percent in June, according to the Eurostat definition.

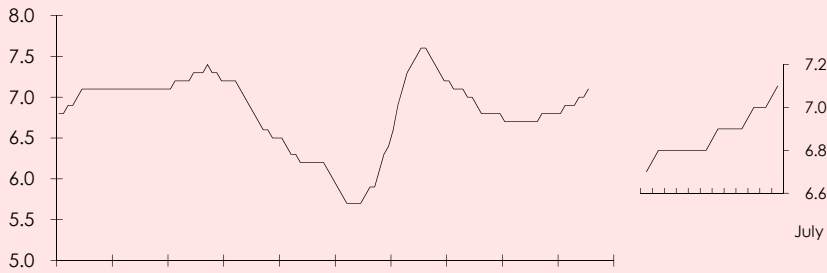
**Employment constant,
unemployment rising**

Figure 3: Key economic indicators

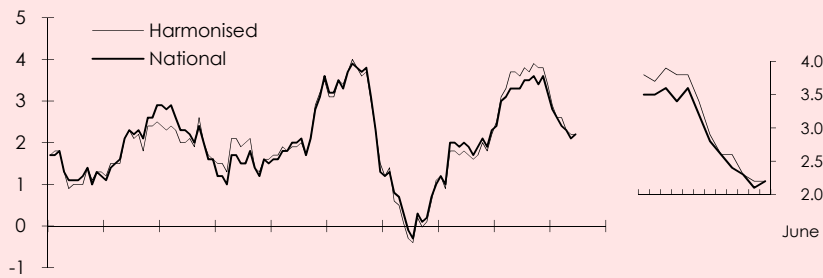
Persons in active dependent employment¹, (1,000), seasonally adjusted



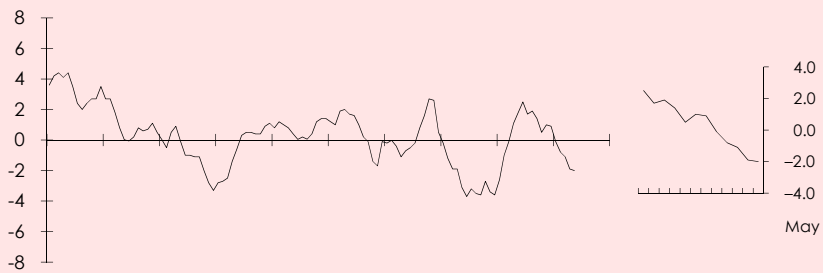
Unemployment rate, traditional Austrian method², seasonally adjusted



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.

*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, reference is made to "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.

Average rates of change

The time given refers to the initial and the final value of the period of computation: hence the average rate 2005-2010 comprises as the first rate of change that from 2005 to 2006, and as the last that from 2009 to 2010.

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.

Production Sector

This term comprises the NACE-2008 sections B, C and D (Mining and Quarrying, Manufacturing, Energy Supply) and is here used in an international comparison.

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/>).

Core inflation as a monetary policy indicator is not clearly defined. WIFO follows the common practice of using the inflation rate excluding the product categories unprocessed food and energy for core inflation. Thus just under 87 percent of the goods and services contained in the consumer price index (CPI 2010) are included in the calculation of core inflation.

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.konjunkturtest.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".

Inflation remains low, reflecting subdued economic activity and rising labour market tensions. The annual rate of consumer price inflation was 2.2 percent in June. The largest upwards pressures came from the housing, water and energy and food and non-alcoholic beverages expenditure categories.

The harmonised rate of inflation (HICP) also was 2.2 percent in June, lower than the euro area average (2.4 percent); core inflation (HICP excluding energy and unprocessed food), by contrast, was slightly higher.

**Price increases
remain moderate**