

Stefan Ederer

Economy Between Slowdown and Stabilisation

Business Cycle Report of May 2019

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In the USA and the euro area, the economy grew more strongly than most recently in the first quarter of 2019. Some indicators continue to point to a slowdown. However, the economy appears to have stabilised somewhat again. In Austria, on the other hand, growth weakened again somewhat in the first quarter. Manufacturing in particular is suffering from the global economic downturn, while the domestic economy is developing robustly. The recovery on the labour market is gradually flattening out. Inflation remains moderate.

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The international economy currently appears to be contradictory: according to initial estimates, gross domestic product in the USA and the euro area grew more strongly than most recently in the first quarter. Other indicators such as industrial production or recent company surveys, though, continue to point to a slowdown in the economy. However, the downturn appears to have slowed at least noticeably. Consumer sentiment in the USA remains positive and the situation on the labour market is favourable. Consumer confidence also stabilised in the euro area at the beginning of the year, but fell noticeably again in April. The mood in the construction and service sectors remains optimistic. However, expectations in the manufacturing sector have clouded over once again.

In Austria, on the other hand, there are still many indications that the economy will cool down, although the pace of the downturn has slowed somewhat here as well. According to preliminary estimates (trend cycle data), in the first quarter the Austrian economy grew by 0.3 percent compared to the previous quarter (fourth quarter +0.4 percent). However, domestic demand, especially private consumption and construction investments, continued to develop robustly. On the other hand, the dynamics of exports and investments in machinery and equipment slowed again in the wake of the global economy. This was particularly reflected in the manufacturing sector, whose value added in the first quarter declined for the first time after the economic peak in the previous year.

According to the WIFO-Konjunkturtest (business cycle survey), corporate sentiment stabilised somewhat in April and continues to be above-average in the economy as a whole. Here, too, the cyclical slowdown is reflected above all in the manufacturing sector, which is less optimistic about future developments. The assessment of order

backlogs and capacity utilisation deteriorated significantly, the current situation was still largely assessed optimistically, however.

The cyclical slowdown is also already affecting the Austrian labour market, although the situation is still relatively favourable. The number of persons in active dependent employment continued to rise in April (+76,000 year-on-year). In the area of unemployment, however, the recovery is coming to an end and the seasonally adjusted unemployment rate according to the national definition stagnated.

Inflation in Austria accelerated somewhat in March, after having fallen continuously in the three preceding months. At +1.8 percent compared with the previous year, however, the rise in consumer prices remained moderate. Important price drivers were the costs of household energy, apartment rents, the maintenance of apartments, restaurants and hotels and the rise in fuel prices.

1. Unexpected strong growth in the USA in the first quarter

According to initial estimates, the US economy grew by +0.8 percent in the first quarter of 2019 compared with the previous quarter and thus significantly more strongly than in the fourth quarter (+0.5 percent). However, the momentum of private consumer spending, the most important driving force of the economy to date, slowed noticeably. In particular, expenditure on motor vehicles fell markedly compared with the previous quarter. After the considerable expansion in the last two years, investments in machinery and equipment stagnated, and investments in residential construction have been declining for more than a year. Public consumption (excluding defence expenditure) fell markedly due to the temporary government shutdown in December and January, but this was offset by the increase in defence expenditure. Inventory investment, on the other hand, increased and net exports rose strongly, about half of which was due to a decline in imports due to weak domestic demand.

The marked increase in retail sales and new orders for durable consumer goods in March, as well as continued highly positive consumer confidence, point to a possible recovery in private consumption in the second quarter. The persistently low unemployment rate (April 3.6 percent) and moderate inflation (March +1.9 percent year-on-year) could also contribute to this.

Industrial production also stabilised in March. However, the ISM Purchasing Managers' Index, which had been relatively stable from January to March after a pronounced decline at the end of 2018, fell sharply in April. Incoming orders and current production were assessed noticeably more pessimistically than before. However, the index remains in optimistic territory.

In the USA, GDP grew much more strongly than expected in the first quarter. Some indicators point to a (moderate) slowdown in the economy.

2. Mixed short-term indicators in the euro area

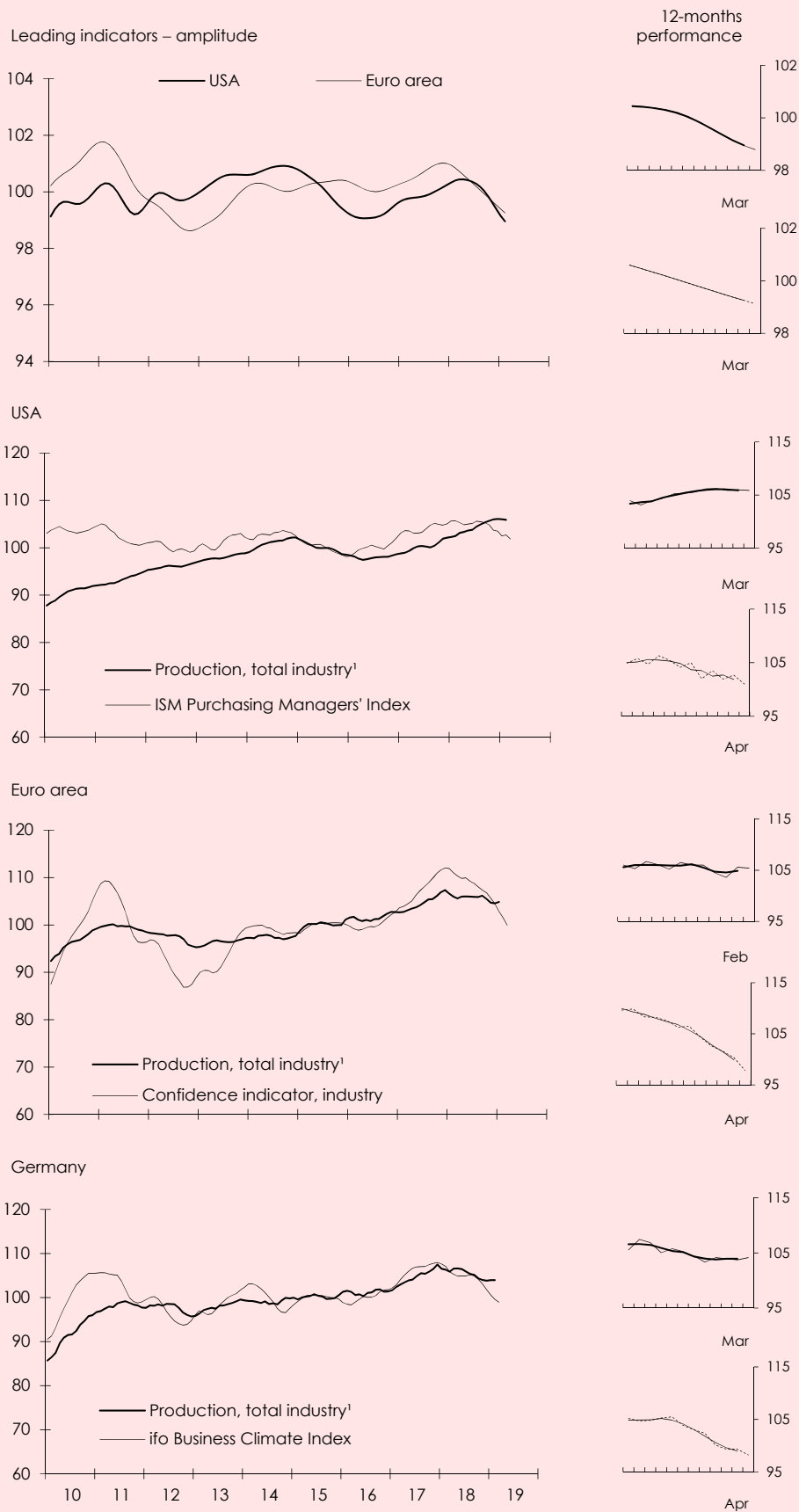
According to preliminary estimates, gross domestic product in the euro area rose by 0.4 percent in the first quarter compared with the previous quarter. After two weak growth rates before that (third quarter of 2018 +0.1 percent, fourth quarter +0.2 percent), the momentum thus strengthened noticeably. So far, only three of the four large euro area countries have published a flash estimate for growth in the first quarter: in France, GDP rose by 0.3 percent compared with the previous quarter, as in the two previous quarters. In Italy, overall economic production increased again in the first quarter (+0.2 percent) after the decline since mid-2018. In Spain, growth accelerated significantly to +0.7 percent, the highest quarter-on-quarter increase in a year.

This noticeable recovery of the economy in the first quarter is partially confirmed by other indicators. Industrial production in the euro area in February was largely stable compared with the previous month, after having risen strongly in January. In the group of large countries, it declined somewhat in Spain in February, while it increased in France and Italy.

In the euro area, growth accelerated considerably in the first quarter. The economy is likely to have stabilised somewhat again.

Figure 1: International business climate

Seasonally adjusted, 2015 = 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.

Corporate assessments have also been mixed recently. The European Commission's European Sentiment Indicator (ESI) for the euro area fell slightly again in April, but remained above the long-term average. Since the beginning of the year, the indicator deteriorated particularly sharply in Germany and Italy and stagnated in France and Spain. The deterioration in sentiment in the euro area was mainly attributable to the manufacturing sector. By contrast, confidence remained largely robust in the construction and services sectors.

Consumer confidence recovered somewhat in the euro area as a whole at the beginning of the year, but fell noticeably again in April. With the exception of Italy, where consumer sentiment declined steadily in recent months, this pattern was reflected in all the major countries in the euro area. The assessment of corporate capacity utilisation for the second quarter declined slightly compared with the previous quarter.

In Germany, the economic barometer of the German Institute for Economic Research (DIW) in April was still slightly below the 100-point mark, which corresponds to the average growth of the German economy. However, the downward momentum recently flattened considerably. The ifo business climate index also fell slightly in April. In the manufacturing sector in particular, sentiment again deteriorated considerably. Export expectations have deteriorated dramatically since the beginning of the year. The difficult global economic environment has apparently provided little impetus for the German economy recently. Industrial production, on the other hand, stabilised in the course of the first quarter of 2019.

Domestic demand in the euro area is supported by the relatively favourable situation on the labour market. The seasonally adjusted unemployment rate fell to 7.7 percent in March, its lowest level since September 2008. Although the downward trend has slowed noticeably since the economic peak in the previous year, a renewed increase in unemployment in the euro area has so far not been seen.

Inflation (HICP) in the euro area was +1.4 percent in March, well below the target inflation rate of the European Central Bank. Core inflation, which reflects the rise in consumer prices excluding unprocessed food and energy, even fell to +1 percent. It has slowed since the beginning of the year in all major euro area countries due to the economic downturn.

3. Growth of the Austrian economy weakens further

According to preliminary estimates (trend cycle data), in the first quarter of 2019 the Austrian economy grew by 0.3 percent compared to the previous quarter (fourth quarter of 2018 +0.4 percent). In particular, private consumption expenditure (+0.4 percent) and construction investments (+0.6 percent) developed robustly. Investment in machinery and equipment (+0.4 percent) and exports (+0.4 percent), on the other hand, continued to lose momentum. This was particularly reflected in the manufacturing sector, whose value added in the first quarter declined for the first time after the economic peak in the previous year. By contrast, the construction industry recorded sustained high growth.

According to the WIFO-Konjunkturtest (business cycle survey) in April, the mood of companies is still confident despite a noticeable decline since the economic peak in 2018. The seasonally adjusted index of the assessment of the current situation for the economy as a whole declined further compared with the previous month, but remained clearly in positive territory. Corporate expectations even stabilised again, with the index continuing to be above the long-term average.

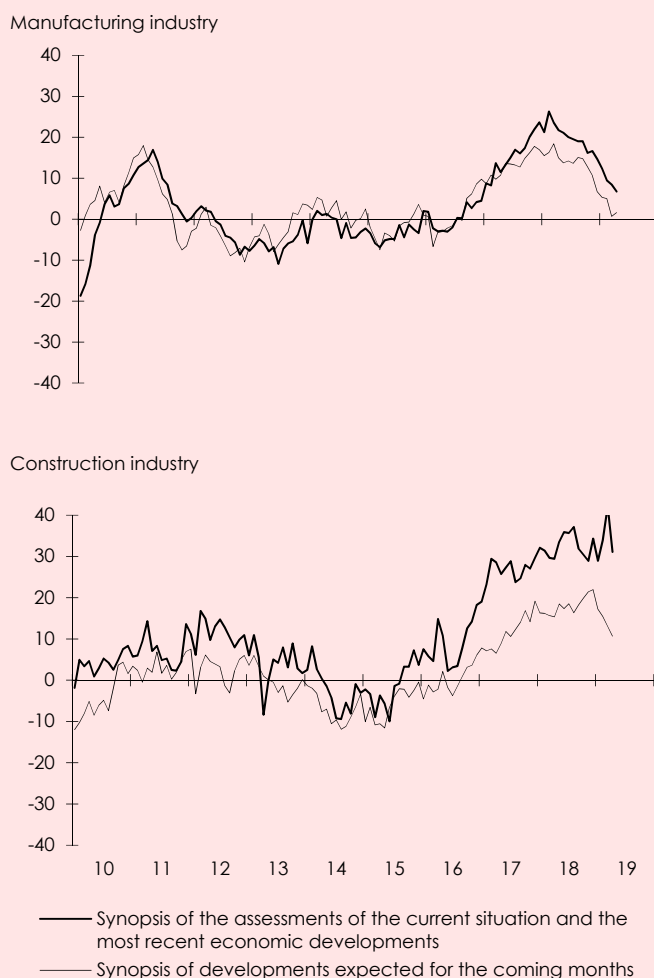
Sentiment clouded considerably, especially in the manufacturing sector. According to the WIFO-Konjunkturtest (business cycle survey), companies were again much more pessimistic about the current situation in April, and the indicator assessing order backlogs and capacity utilisation declined. However, the index of the current situation remained positive. However, the future development of the manufacturing industry is no longer viewed optimistically, although the assessment has stabilised somewhat. In the construction and services sectors, on the other hand, corporate sentiment remained clearly positive.

In Austria, economic growth again weakened slightly in the first quarter. By contrast, corporate economic sentiment has stabilised somewhat and remains predominantly positive.

According to Bank Austria's Purchasing Managers' Index for industry, the situation is somewhat more pessimistic: in April it fell below the growth threshold of 50 points for the first time since March 2015. The production index for Austrian industry has not yet weakened, but rose again in February. According to the European Commission's business survey, though, consumer confidence fell sharply in April.

Figure 2: Results from the WIFO-Konjunkturtest

Indices of the assessment of the current economic situation and of business expectations, seasonally adjusted



Source: WIFO-Konjunkturtest. Data refer to index points (percentage points) between +100 and -100. Values above 0 imply positive expectations, values below 0 indicate negative expectations.

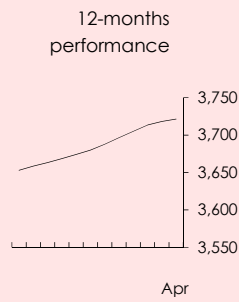
3.1 Labour market recovery flattens out

The cyclical slowdown is also affecting the labour market, although the situation is still relatively favourable. According to estimates by the Ministry of Social Affairs, 76,000 more people were actively employed in April than in the previous year (+2.1 percent). Seasonally adjusted, however, this means only a slight increase of 3,300 compared to the previous month (+0.1 percent). The unemployment rate according to the national definition stagnated and stood at 7.4 percent in April, seasonally adjusted. According to Eurostat, the unemployment rate was 4.8 percent in March.

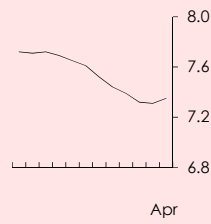
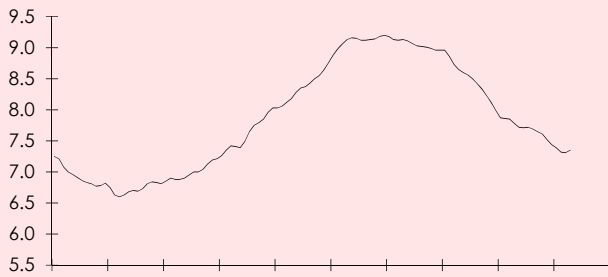
The recovery on the labour market is flattening out: although employment continues to rise significantly, the seasonally adjusted unemployment rate is stagnating.

Figure 3: Key economic indicators

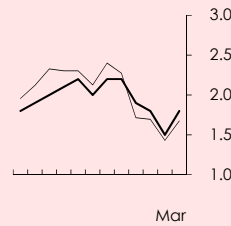
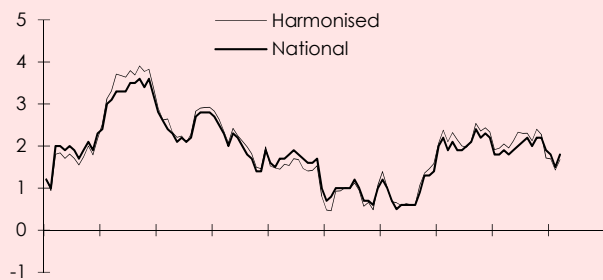
Persons in active dependent employment¹, 1,000s, seasonally adjusted



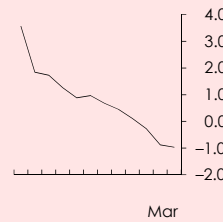
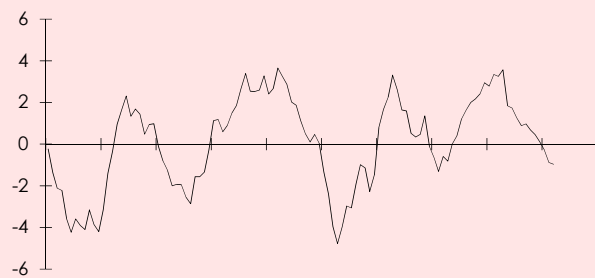
Unemployment rate, traditional Austrian method², seasonally adjusted



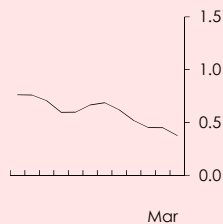
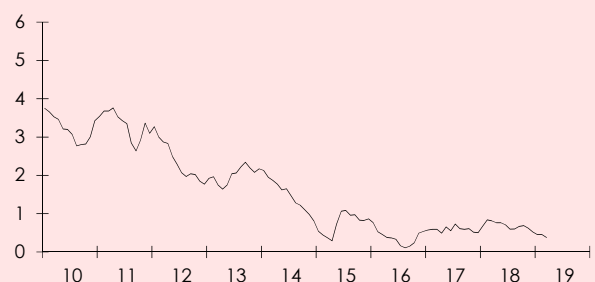
Consumer prices, year-to-year percentage changes



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



10-year central government bonds (benchmark), percent



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

Compared to the previous year, however, the number of unemployed remained significantly lower. The number of unemployed over the age of 50 and those with health limitations rose slightly. On the other hand, the number of unemployed young people and long-term unemployed was again lower than 12 months ago.

3.2 Moderate price increases due to significant inflation in housing, restaurants and fuels

Inflation accelerated again somewhat in March, after having fallen continuously in the previous three months. However, consumer price inflation remained moderate at +1.8 percent year-on-year. An important price driver was once again the category "housing, water, energy", which reflected the sharp rise in the cost of household energy (+4.3 percent), rents (+3.3 percent) and maintenance costs (+2.8 percent). Restaurant and hotel services also cost on average 2.8 percent more than in the previous year, and in the transport sector fuel prices in particular rose (+5.2 percent).

The prices of the micro basket, which mainly contains food and reflects daily shopping, hardly increased (+0.2 percent) compared to the previous year. However, this index rose sharply in 2017 and 2018 and is currently being depressed by the sharp fall in apple prices. But also prices in the category "food" as a whole rose only moderately on average (+1.5 percent). The mini basket, which represents weekly purchases, cost 2.2 percent more than in the previous year due to higher fuel and service prices.

Consumer prices have recently again risen moderately. Price drivers were energy and fuels, rents and catering services.