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Slight Economic Recovery in Austria

Business Cycle Report of December 2015

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Economic activity in Austria is accelerating only slightly. Stimulus is being provided by exports and equipment investment, while private consumption remains weak. WIFO's Business Cycle Survey shows a modest improvement in firms' assessments. Consumer confidence, on the other hand, has deteriorated. The external environment remains tense. A significant cyclical upturn is unlikely also in the coming months.

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The Austrian economy continues to grow at a modest pace. Gross domestic product increased at a quarterly rate of 0.3 percent in the third quarter. The external environment remains tense: the US economy is in good shape, even though first signs are pointing to a slowdown. In the euro area, by contrast, economic activity still lacks momentum, while growth in emerging market economies has slowed.

The uneven development of the global economy is reflected in Austria's foreign trade: export growth accelerated somewhat in the third quarter, to +1.5 percent, according to the national accounts. Demand from the USA increased markedly. By contrast, the ongoing economic weakness in the euro area and the slowdown of expansion in emerging market economies act as a drag on Austrian exports.

In the third quarter, stimulus was also provided by equipment investment, which expanded considerably for the second consecutive time. This may be related to a gradual improvement in Austrian companies' assessment of economic conditions. However, the investment rebound remains lacklustre. Construction investment declined further in the third quarter, indicating that the weakness of activity observed in the Austrian construction sector has not been overcome yet.

The tourism industry experienced vigorous growth in the last summer season; guest arrivals reached a new peak. Notwithstanding a decline in expenditure per night spent, tourism sales increased considerably compared with last year.

Unlike in Germany and in several other European countries, private consumption in Austria again barely expanded in the third quarter. Consumer confidence has been deteriorating markedly since spring 2015, and in November reached the lowest level recorded since the 2008-09 crisis. Therefore household consumption is anticipated to remain weak also in the coming months. However, the migration of refugees and the tax reform, which will enter into force at the beginning of 2016, may provide considerable stimulus to consumption.

A factor also influencing the lacklustre development of private consumption is the tense labour market situation. In November, the number of persons registered as unemployed increased by 27,500 compared with a year before, despite employment gains. The unemployment rate rose to 9.2 percent. On a seasonally adjusted basis, however, the number of unemployed persons did not continue to rise, and job vacancies increased further. The harmonised unemployment rate according to Eurostat stood unchanged at 5.6 percent in October.

Inflation remained steady at +0.7 percent in October. Sharp falls in commodity and energy prices exerted downward pressures on consumer prices. By contrast, rents, services related to the provision of food and drink, and insurance services continued to act as price boosters.

1. No signs of pick-up in global economic growth

Global economic growth shows no signs of accelerating. World trade even shrank somewhat in August and September (three-month moving average growth rate), according to Centraal Planbureau (CPB). However, global economic developments have been mixed: the slowdown is clearly noticeable in emerging market economies in Asia, Latin America and Eastern Europe, where imports dropped further in September. Industrial production also declined in all regions except Asia. By contrast, merchandise imports rose considerably in the USA and also picked up slightly in the euro area. The weakness of the global economy is also apparent in commodity markets: prices dropped markedly in the summer on the back of subdued demand. After stabilising somewhat in the autumn, they fell yet again in November; hence the phase of economic weakness is likely not over yet. Economic activity in the USA remained lively, with gross domestic product expanding at a quarter-on-quarter rate of 0.5 percent in the third quarter. While this was a noticeable slowdown compared with the extraordinarily strong growth recorded in the second quarter (+1.0 percent), the rate was still in line with the average for recent years. Economic activity was primarily driven by private consumption, which continued to expand vigorously. Industrial production, by contrast, largely stagnated.

Economic activity in the USA is expected to slow in the coming months: the ISM Purchasing Managers' Index for the first time fell again below the expansion threshold in November, and the Conference Board's Consumer Confidence Index also deteriorated. According to the University of Michigan's consumer survey, on the other hand, assessments improved in October, but have been moving broadly sideways since the beginning of the year. A potential weakening of consumer demand in the USA would act as a significant drag on economic activity there.

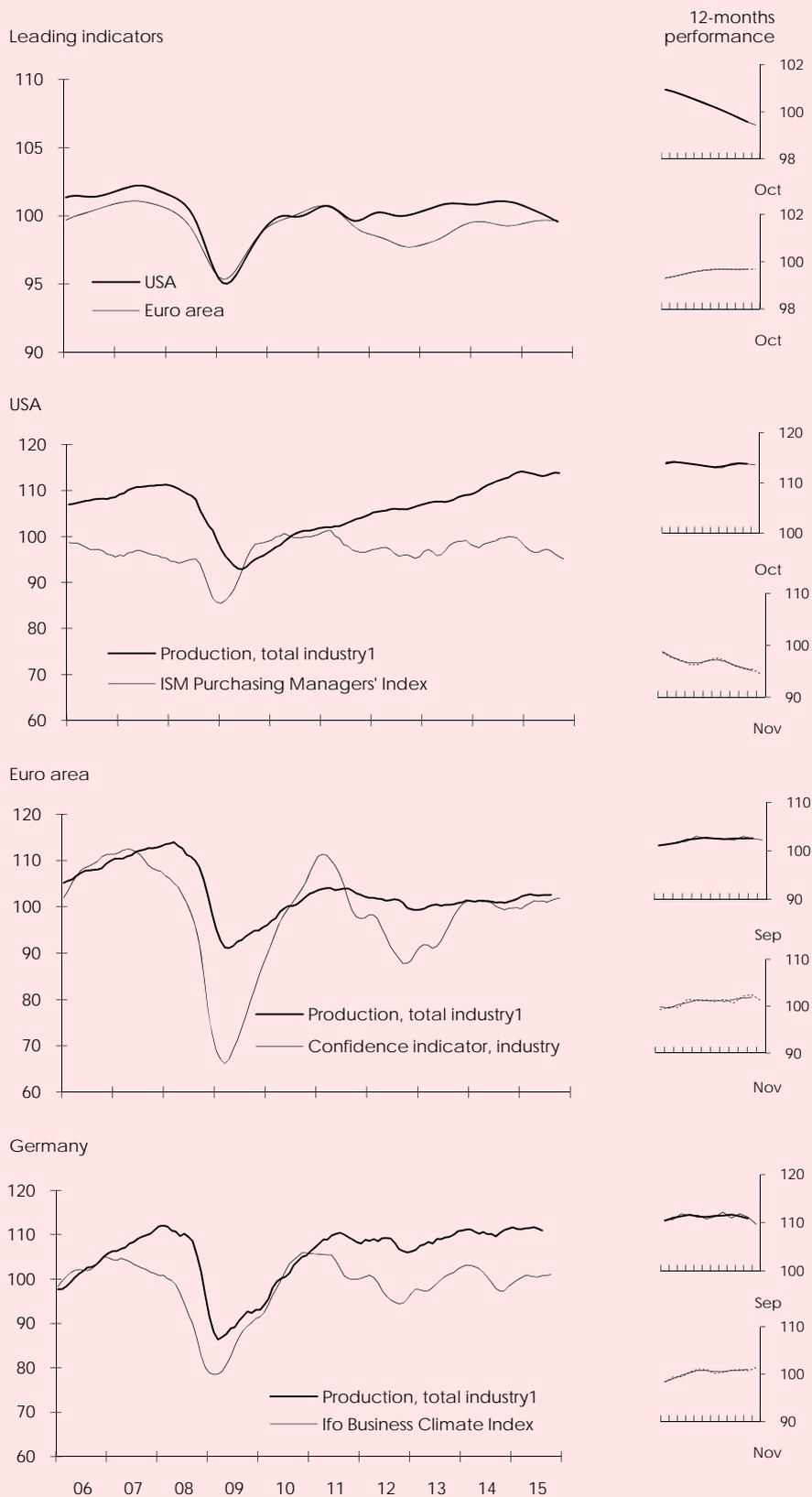
In view of these developments, the central bank of the USA so far has been hesitant to end its zero interest rate policy and raise its key interest rate, which has been near 0 percent since the end of 2008. The relatively low unemployment rate would justify such a turnaround in monetary policy, whereas the low inflation rate – it rose marginally to 0.2 percent in October – bars it. The core inflation rate (excluding energy and food), which is important for the assessment of domestic price pressures, remained steady at just under 2 percent, however. The interest rate policy decision is to be taken in December. The Fed already in November held out the possibility that it would take a first step to change interest rates at the end of this year.

The economies of most emerging market countries continue to suffer from the sharp fall in commodity prices. Brazil and Russia are in recession. China's economy, by contrast, expanded vigorously also in the third quarter at a quarter-on-quarter rate of 1.8 percent. Nevertheless, growth momentum in China appears to be softening. This may be related to the structural change away from a purely export-oriented economy and towards more strongly domestically-driven growth. Stock prices have recovered somewhat in recent months, after the sharp price correction in the summer. Apparently the bursting of this bubble has barely affected the real economy.

While economic activity in the USA remains robust, there are first signs of a slowdown. The collapse in commodity prices and structural change in China restrain growth in emerging market economies.

Figure 1: International business climate

Seasonally adjusted, 2010 = 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.

2. Economic activity in euro area remains weak

Economic activity in the euro area remains weak, the recovery has not yet turned into an upswing. The growth momentum even softened again somewhat in the third quarter, with gross domestic product growing by 0.3 percent compared with the previous quarter (second quarter +0.4 percent). This slowdown was registered in almost all euro countries, except only for France, where GDP grew more vigorously in the third quarter than in the previous three months.

In the large euro area countries, economic activity in recent months has been mainly driven by private consumption, which increased markedly in Germany, France and Spain in the third quarter. By contrast, gross fixed capital formation remained subdued. Firms' investment behaviour has become very cautious, given the sluggish industrial activity. Foreign trade also barely provides any stimulus at present. While in general exports barely accelerated, imports rose briskly owing to lively consumer demand.

The weak underlying trend in economic activity is likely to persist. Industrial production even decreased again slightly in the euro area in September, largely owing to developments in Germany. By contrast, industrial production in France and Spain expanded further. Industrial confidence continued to deteriorate in all large euro area countries in November, according to the European Commission's business survey.

Consumer confidence in the euro area as a whole is still moving slightly upward and increased considerably in France and Italy in November. By contrast, survey data show that consumers' assessments have worsened markedly in Germany since the summer. Consumer confidence did stabilise again in November, though. According to the Economic Barometer released by the German Institute for Economic Research (DIW), private consumption in Germany should remain stable also in the fourth quarter of 2015, and gross domestic product is expected to grow at a similar pace as that recorded in the autumn.

The outlook for the construction sector in the euro area has been improving since the end of 2012. The confidence index continued its brisk rise also in November. This upward movement has been observed in all large countries. It started from a very low level, however; overall, the confidence indicator is in line with its long-term average.

The labour market situation is also improving in parallel with the gradual recovery of economic activity. The unemployment rate in the euro area fell further, to 10.7 percent in October (September 2015: 10.8 percent, October 2014: 11.5 percent). The lowest unemployment rate was recorded in Germany (4.5 percent), the highest in Greece (24.6 percent in August) and in Spain (21.6 percent), respectively.

Euro area inflation stood unchanged at 0.1 percent in November, according to the flash estimate. Weak aggregate demand and the decline in commodity prices had previously pulled it down to below 0 percent. Strong deflationary trends are still apparent in Slovenia, Spain and Cyprus. But the inflation rate is barely positive also in Germany, France and Italy. By contrast, more substantial price increases were recorded in Belgium, Malta, Portugal and Austria.

Given the weak price dynamics – the inflation target is below, but close to, 2 percent – the European Central Bank in December lowered the interest rate on the deposit facility and announced that government bond purchases ("quantitative easing") would be continued at least until March 2017. Hence, for the first time since the crisis, diverging monetary policies are likely to be seen worldwide in the coming months: While the ECB will maintain its expansionary stance, the Fed is expected to slightly raise interest rates.

The economic recovery in the euro area has not yet turned into an upswing. The weak underlying trend is likely to persist also in the coming months, despite the expansionary monetary policy.

3. Modest expansion in Austria continues

The Austrian economy continues to recover at a modest pace; gross domestic product grew by 0.3 percent in the third quarter. Unlike in Germany and several other countries of the monetary union, private consumption in Austria remained subdued also in the third quarter, however, rising at a quarterly rate of only 0.1 percent for the third consecutive time. This is reflected also in persistently weak growth in the retail sector (excluding cars).

Equipment investment, on the other hand, rose considerably for the second time in a row in the third quarter (+1.2 percent, compared with the previous quarter). This tentative recovery of investment activity may be related to the gradual improvement in Austrian firms' assessment of economic conditions. In WIFO's Business Cycle Survey of November, companies assess the present economic situation more favourably than in previous months. They have also become considerably more upbeat about the outlook for the coming months. In the manufacturing sector, however, the assessment of the present situation deteriorated somewhat in November, while expectations for the coming months are somewhat more optimistic. This trend is confirmed by the renewed decline in the production index for manufacturing.

At the same time construction investment continued its declining trend also in the third quarter (-0.2 percent). According to WIFO's Business Cycle Survey of November, Austrian construction companies assess both their present situation and the coming months more positively, but the outlook remains mostly negative.

Austria's foreign trade sector was only little affected in the autumn by the ongoing difficult situation in many foreign markets. According to the national accounts, export growth accelerated to +1.5 percent, quarter on quarter, in the third quarter. At the same time imports, notably those of capital goods, also rose briskly (+1.8 percent), however, with consequently net trade overall contributing negatively to growth. Especially manufacturing benefitted from the export and investment demand, with value added in this sector increasing at a quarter-on-quarter rate of 0.7 percent in the third quarter. But value added rose considerably also in trade, transport, hotels and restaurants (+0.5 percent) as well as in real estate and housing (+0.9 percent) and in public administration (+0.4 percent).

The relatively favourable performance of the Austrian export industry was driven especially by buoyant demand from the USA (cumulative value of merchandise exports from January to September +19 percent, year on year). Exports to Turkey and East Central European countries also increased sharply. By contrast, exports to the euro area, still by far the most important sales market for Austrian companies, rose only modestly (+1.2 percent), owing to the sluggishness of activity there. Exports to Germany, Austria's key trading partner, picked up markedly again from June onwards, however. Weak activity in emerging market economies also had a noticeable effect: Exports to China stagnated, those to Latin America fell substantially (-9 percent), while the demand from Russia (-39 percent) and Ukraine (-43 percent) plummeted.

Tourist arrivals between May and October reached a new peak at 21.85 million (+6.3 percent, year on year). The number of nights spent also rose vigorously (+3.3 percent, to 69.40 million); only in the 1994 summer season had it been slightly higher. The demand from abroad grew somewhat more briskly than domestic demand.

An increase in the number of overnight stays was registered in all major foreign source markets except for Russia, where demand for Austrian tourism services is still affected by the sharp fall in the rouble exchange rate and political conflicts with the EU, as well as Belgium and Russia. This development benefitted from the decline in the euro exchange rate.

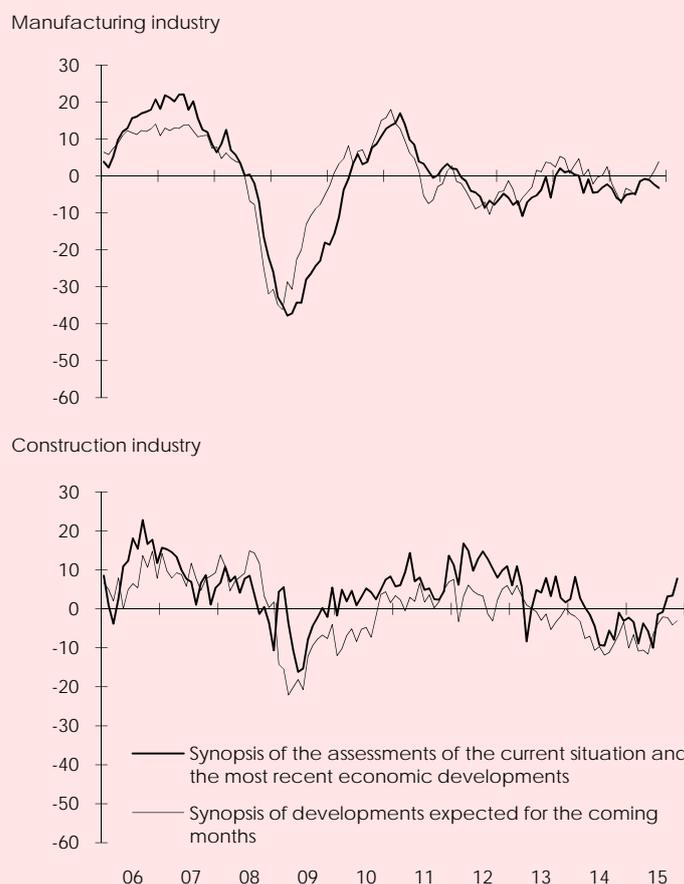
The demand from Germany and the Netherlands, the most important countries for Austrian tourism (together accounting for 59.6 percent of nights spent by foreigners and 41.5 percent of total demand) grew at a somewhat slower pace at +0.4 percent and +2.7 percent, respectively; the number of nights spent by German guests

Austrian GDP increased by 0.3 percent quarter on quarter in the third quarter. Stimulus was provided by exports and equipment investment. Private consumption, by contrast, remains extremely weak.

plummeted in October. This decline is likely to have been related to the bad weather and the impediments faced when crossing the border between Austria and Germany.

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.

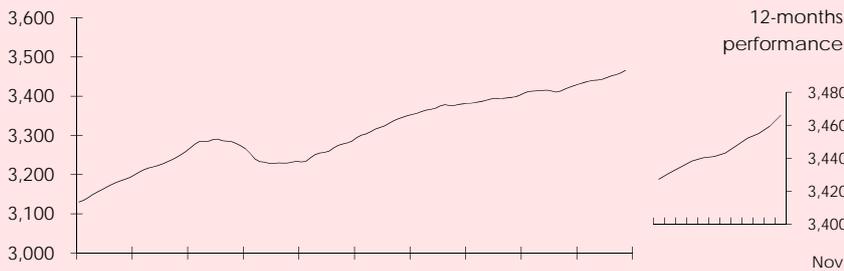
3.1 Economy to improve slightly in coming months

The economic situation in Austria is expected to improve slightly in the coming months. WIFO's Business Cycle Survey of November 2015 indicates an improvement in firms' assessments both of the current situation and future prospects. In a long-term comparison, assessments are again reaching their average levels, suggesting that the overall economic environment is slowly approaching a state companies regard as normal. The results of WIFO's Business Cycle Survey are heterogeneous, however: in manufacturing, the Present Situation Index continued its descent. Negative assessments predominated over positive appraisals, and for the second time in succession the index dropped below its long-term average. In particular export order books were assessed as being unsatisfactory. However, companies' expectations regarding future developments improved further in November. The results for the individual segments of manufacturing reflect the drivers of growth: assessments were considerably more favourable in the capital goods sector than in the consumer goods sector. Positive signals are being provided by the Bank Austria Purchasing Managers' Index. Notwithstanding a first slight decline in November, it is still within the range signalling an expansion of manufacturing activity.

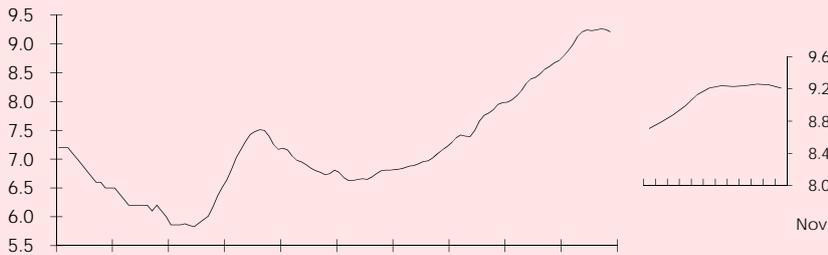
Firms' assessments of the economic situation have become slightly more positive, according to WIFO's Business Cycle Survey. Consumer confidence has deteriorated, however, indicating that private consumption will still not grow briskly. The tax reform and refugee migration may provide a stimulus.

Figure 3: Key economic indicators

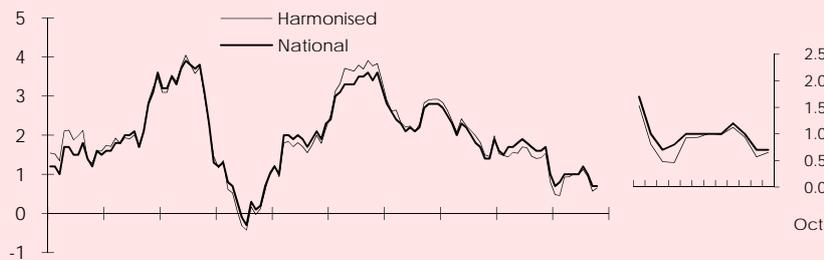
Persons in active dependent employment¹, (1,000), seasonally adjusted



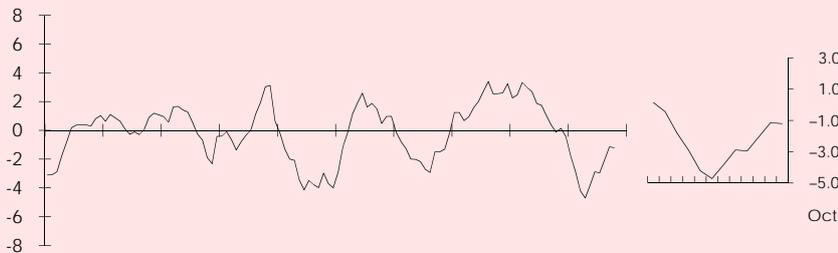
Unemployment rate, traditional Austrian method², seasonally adjusted



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.

WIFO's Business Cycle Survey shows a marked upward trend for the construction industry: firms assessed both the present situation and the coming months more favourably in November than a month before; the outlook remains mostly negative, though. Firms' financing conditions are also improving: according to WIFO's Business Cycle Survey of November, the share of firms judging bank lending practices as being "restrictive" declined further.

Unlike firms' assessments, consumer confidence has been deteriorating considerably since spring 2015, however, with the respective indicator in November dropping to the lowest level recorded since the 2008-09 crisis. Hence consumer demand should remain weak also in the coming months. But the refugee migration and the relief through the tax reform that will enter into force at the beginning of 2016 may provide substantial stimulus to private consumption. WIFO's Leading Indicator, a weighted index made up of ten indicators from the real economy and the financial sector, continues to signal improvement in economic activity. It rose on a month-on-month basis also in the current analysis.

3.2 Labour market situation remains difficult

Given the sluggishness of activity, the labour market situation is still not improving. While the number of persons in dependent active employment rose by around 33,000 (+1.0 percent) in November compared with a year before, according to provisional estimates, the number of persons registered as unemployed with the AMS (Public Employment Service) increased as well (+27,500, +8.3 percent). Part of this increase may be attributable to the decline in the number of persons enrolled in vocational training (-4,600).

However, the seasonally adjusted number of unemployed persons stagnated in November compared with the previous month (-1,000, -0.3 percent). Job vacancies also rose further (+6,300 compared with a year before, +1,200 compared with a month before).

The unemployment rate increased to 9.2 percent in November (October 8.7 percent). However, on a seasonally adjusted basis, the rate remained stable compared with the previous month. The harmonised unemployment rate according to Eurostat stood unchanged at 5.6 percent in October.

3.3 Consumer Price Inflation dampened by plummeting oil price

The inflation rate remained steady in October, compared with the previous month; compared with a year before, consumer prices increased by 0.7 percent. Price developments were dominated in particular by the fall in global oil prices (October -42 percent in dollar terms, compared with a year before). Fuel prices in Austria were down 17 percent on last year.

A large contribution to inflation came from services related to the provision of food and drink (price increases of 3.4 percent compared with a year before), apartment rents (+3.7 percent) and insurance services (+2.6 percent). The Harmonised Index of Consumer Prices (HICP) also exceeded the year-earlier reading by 0.7 percent in October. Hence inflation was noticeably higher than in Germany (+0.2 percent) and in the euro area as a whole (+0.1 percent). This inflation differential is attributable to markedly higher price increases for services in Austria.

The number of unemployed persons rose considerably in November compared with a year before, despite employment gains. On a seasonally adjusted basis it did not increase further, however. The number of job vacancies is also on the rise.

Austria's inflation rate stood unchanged at +0.7 percent in October. Marked increases in rents and in the prices of services related to the provision of food and drink were counterbalanced by the decline in fuel prices.