Markus Marterbauer

Slack Demand and a Weaker Dollar Weighing on Business Activity

Demand and output in Austria are stagnating. Indications for a revival of business fixed investment are absent, and growth of private consumption is likely to remain modest. Exports are losing momentum, as the main trading partners are also struggling with economic sluggishness, which is compounded by the decline in the dollar exchange rate. Inflation has decelerated markedly, while unemployment keeps rising.

All staff members of the Austrian Institute of Economic Research contribute to the Business Cycle Report. • Cut-off date: 4 June 2003 • E-Mail Address: Markus.Marterbauer@wifo.ac.at

Domestic business activity continues to be suffering from slack overall demand, with prospects for a recovery still vague. Since the beginning of the year, also the incentives from foreign demand are flickering, which have sustained GDP growth over the last two years. In January and February, nominal merchandise exports rose by a mere 2 percent year-on-year. While demand from south-eastern Europe was buoyant, deliveries to other EU countries and to East-Central Europe receded. Current receipts from exports in the first quarter did not exceed the year-earlier level.

The fading of export growth mirrors the sluggish business conditions with key trading partners. The euro area economy is in stagnation. Germany may have entered another recession, after 2001, as GDP in the first quarter 2003 edged down by a seasonally-adjusted 0.2 percent from the previous period. The critical state of the European economy, now lasting for two years, is mainly due to the lack of internal demand. The weakness of investment and consumption is now being compounded by the export-dampening depreciation of the dollar vis-à-vis the euro. The exchange rate shifts will affect production with the usual lag of two or three quarters. According to the "euro growth indicator", euro-area growth may already be reduced by ½ percentage point in the third quarter. Austrian exports go primarily to the euro area or to countries exhibiting a stable exchange rate to the euro; they are therefore mostly indirectly affected by the euro appreciation, e.g., via supplies to the German export industry.

The effective appreciation of the euro and the return of oil prices to more normal levels are slowing markedly the pace of inflation in the euro area. While a general and sustained fall in consumer prices EU-wide ("deflation") appears unlikely at present, it cannot be ruled out for particular member states, such as Germany. In Austria, the consumer price index edged down by 0.1 percent in April, to an annual rate of 1.3 percent. The fall in energy costs is set to continue.

Slower export growth is also weighing on investment and production of Austrian manufacturing. Indications for the persistent restraint in capital spending are offered by weak survey data, but also by the import statistics, since Austrian investment in machinery and equipment exhibits a high import content. In January and February, machinery and motor vehicle imports were 2¾ percent lower in value than one year ago. Up-to-date figures for output of manufacturing, trade and construction have not become available since end-2002, due to the considerable lags involved in the data collection by Statistik Austria. This renders the assessment of the current business situation particularly difficult. The regular WIFO business survey suggests for the first quarter 2003 a stagnation of manufacturing output compared with the year-earlier level, which would be in line with the observed fall in industrial employment by 2¼ percent year-on-year between January and April.

Retail sales may have increased moderately in the first quarter, according to preliminary estimates, while wholesale trade and motor car sales have fared somewhat better. The construction industry now seems to have passed the cyclical trough. Already in the second semester 2002, activity headed up in civil engineering, benefiting from rising orders for infrastructure investment. The WIFO business survey now suggests a revival also for building construction. Still, these early positive signs have not prevented construction employment from falling by a further 1¾ percent year-on-year between January and April.

The labour market situation remains fragile overall. Growth of total output is still too low as to generate an increase in full-time employment. If official job figures are pointing up, this is entirely due to the trend rise in part-time work and more people being enrolled in training offered by the labour market service, who are counted as being employed. The rising number of participants in such training (+9,000 year-on-year in May) is at the same time dampening the increase in the number of unemployed (+7,000).