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Economic Boom Continues

Business Cycle Report of March 2007

Economic growth, which in 2006 accelerated to 3.2 percent, showed no signs of moderation at the beginning of 2007. Judging from business surveys, the economic climate continues to be excellent, and investment plans for 2007 have been revised noticeably upwards. The situation on the labour market has been improving considerably. As a result, consumer confidence is strengthening and the probability of a revival of private consumption, which could prolong the economic upswing, is increasing.

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2006 was an extremely successful year for the Austrian economy. Real GDP advanced by 3.2 percent despite the fact that there were two working days less than the year before. This was the highest growth rate since 2000 (+3.4 percent). The fourth quarter saw real GDP rising by 0.8 percent (seasonally and working-day adjusted) from the previous period (third quarter +1.0 percent). In year-on-year terms, the increase was 3.3 percent.

In 2006, the stimulus to growth came primarily from abroad. Austrian exports expanded at a vigorous pace thanks to brisk international demand (+8.5 percent in real terms), with notably goods exports posting strong gains (+10.2 percent). Following some moderation since the beginning of the year compared with the same period a year earlier, the latter once more gathered momentum in the fourth quarter (+2.3 percent).

2006 also saw a pickup in investment demand. Gross fixed investment rose by 4.7 percent in real terms. An increase was recorded both for machinery and equipment investment (+5.3 percent) and for investment in buildings (+4.6 percent).

While the pace of economic activity in the USA is decelerating, the boom in the EU continues. Investment demand is turning into a main driver of growth. Private household consumption is still growing at a rather slow pace, but framework conditions for a pickup are improving due to the ongoing favourable economic situation. The labour market in Europe has begun to benefit from the boom, which in turn leads to an improvement in the income situation. The subdued consumer demand is reflected in an – in this phase of the business cycle – unusually low rate of inflation.

The Austrian economy is also at the peak of its growth. Evidence from business surveys points to a continuation of this trend in the coming months, with only the construction sector anticipating a gradual slowdown in the growth momentum.

Following the already brisk acceleration in investment demand in 2006, companies intend to expand once more their capital stock significantly, according to the WIFO investment survey. The primary investment motive, especially that of bigger companies, is an expansion of capacities. Following the excellent export performance in 2006, exports are set to grow at a slightly slower pace. While intra-European trade is expected to continue its brisk growth, the demand from overseas – notably from the USA – is set to decline.

The sectors currently benefiting most from the brisk expansion of the economy are manufacturing, business services and construction, with the latter gaining also from

the mild weather. These economic sectors are also recording the highest employment gains. The mild winter with its meagre snowfalls has been less favourable for tourism. Nonetheless, the result in terms of overnight stays in the first half of the winter season was just as excellent as last year's, while in nominal terms sales were even slightly higher.

Table 1: Quarterly national accounts

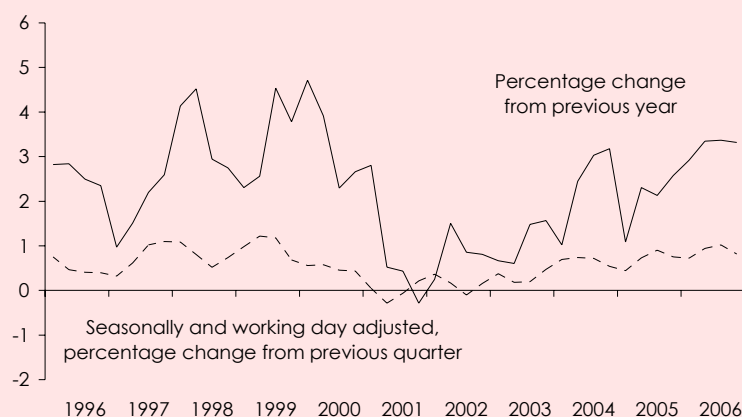
			2005		2006			
			Third quarter	Fourth quarter	First quarter	Second quarter	Third quarter	Fourth quarter
Percentage changes from previous quarter								
<i>Adjusted for seasonal and working day effects, volume</i>								
Final consumption expenditure			+ 0.6	+ 0.4	+ 0.3	+ 0.4	+ 0.5	+ 0.4
Households ¹			+ 0.6	+ 0.5	+ 0.3	+ 0.5	+ 0.7	+ 0.5
General government			+ 0.4	+ 0.3	+ 0.3	- 0.0	+ 0.0	+ 0.2
Cross capital formation			+ 0.3	+ 0.7	+ 0.9	+ 0.9	+ 0.6	+ 0.2
Gross fixed capital formation			+ 0.5	+ 0.8	+ 1.2	+ 1.3	+ 1.3	+ 1.1
Machinery and equipment			+ 0.9	+ 0.9	+ 0.9	+ 1.5	+ 1.9	+ 1.4
Construction			+ 0.4	+ 0.8	+ 1.3	+ 1.3	+ 1.2	+ 0.7
Exports, goods and services			+ 2.0	+ 1.7	+ 2.6	+ 1.8	+ 1.8	+ 1.9
Goods			+ 2.4	+ 2.1	+ 2.7	+ 2.3	+ 2.0	+ 2.3
Services			+ 1.8	+ 1.7	- 0.4	+ 1.5	+ 1.4	+ 1.4
Imports, goods and services			+ 1.5	+ 1.3	+ 2.3	+ 1.5	+ 1.1	+ 0.5
Goods			+ 1.7	+ 1.5	+ 1.7	+ 1.9	+ 1.2	+ 0.4
Services			+ 1.0	+ 1.0	+ 3.4	+ 1.1	+ 1.3	+ 1.3
Gross domestic product			+ 0.9	+ 0.8	+ 0.7	+ 0.9	+ 1.0	+ 0.8
Manufacturing			+ 2.5	+ 2.0	+ 1.8	+ 2.0	+ 2.6	+ 2.4
		2005	2006	2005		2006		
				Third quarter	Fourth quarter	First quarter	Second quarter	Third quarter
				Percentage changes from previous year				Fourth quarter
<i>Volume, chained prices</i>								
Final consumption expenditure	+ 1.8	+ 1.6	+ 1.9	+ 2.3	+ 1.4	+ 1.8	+ 1.7	+ 1.4
Households ¹	+ 1.7	+ 1.8	+ 2.0	+ 2.5	+ 1.3	+ 2.1	+ 2.2	+ 1.7
General government	+ 1.9	+ 0.9	+ 1.8	+ 1.8	+ 1.9	+ 0.8	+ 0.4	+ 0.4
Cross capital formation	- 0.4	+ 4.3	+ 1.1	- 2.7	+ 4.6	+ 5.0	+ 6.7	+ 1.4
Gross fixed capital formation	+ 0.3	+ 4.7	+ 0.2	- 0.6	+ 4.4	+ 3.2	+ 5.6	+ 5.5
Machinery and equipment	+ 0.2	+ 5.3	+ 0.7	- 2.6	+ 4.8	+ 3.8	+ 5.8	+ 6.7
Construction	+ 0.4	+ 4.6	- 0.1	+ 0.8	+ 4.7	+ 3.0	+ 5.7	+ 4.8
Exports, goods and services	+ 6.4	+ 8.5	+ 6.4	+ 6.6	+ 10.7	+ 7.4	+ 6.9	+ 9.2
Goods	+ 5.8	+ 10.2	+ 5.3	+ 5.7	+ 14.5	+ 6.9	+ 8.8	+ 10.9
Services	+ 8.1	+ 3.9	+ 9.2	+ 9.6	+ 1.5	+ 9.0	+ 2.0	+ 3.8
Imports, goods and services	+ 5.2	+ 6.8	+ 5.5	+ 1.9	+ 9.6	+ 5.6	+ 6.5	+ 5.7
Goods	+ 5.9	+ 6.8	+ 6.4	+ 1.7	+ 10.3	+ 5.3	+ 6.1	+ 5.6
Services	+ 2.6	+ 6.8	+ 2.5	+ 2.9	+ 6.7	+ 6.6	+ 7.7	+ 6.1
Gross domestic product	+ 2.0	+ 3.2	+ 2.1	+ 2.6	+ 2.9	+ 3.3	+ 3.4	+ 3.3
Manufacturing	+ 2.6	+ 7.4	+ 3.9	+ 7.0	+ 6.1	+ 6.1	+ 8.6	+ 8.5
Gross domestic product, value	+ 3.9	+ 4.6	+ 3.9	+ 4.2	+ 3.8	+ 4.9	+ 4.7	+ 4.9

Source: WIFO. – ¹ Including private non-profit institutions serving households.

Despite the robust growth of demand in the overall economy, inflation at a rate of 1.6 percent remained relatively low in January. The quick rise in electricity and gas prices was offset by the dampening effect of the early winter sale. The partial indices also show no signs of an upward drift in prices due to the economic situation.

By contrast, there have been extremely strong repercussions on the labour market. In February the number of persons in active dependent employment – which normally reacts with some lag to a rebound of the economy – exceeded the year-earlier level by almost 79,000. This increase by 2.6 percent was the highest one in the last 16 years. At the same time the number of persons registered as unemployed declined markedly (-35,000, -11.2 percent). A factor that contributed to this development – apart from the excellent performance of the economy – was the mild winter weather. The unemployment rate (according to the national method of calculation) dropped to 7.8 percent, a decline by 1.1 percentage points from a year earlier. The rate was also lower compared with the previous month – based on seasonally adjusted figures.

Figure 1: Growth of real GDP



Source: WIFO.

After a strong rise in GDP at the beginning of 2006 (+1.4 percent in real terms from the previous period in the first quarter) growth flattened visibly in the USA. The US economy has expanded at a rate of just around 0.5 percent since the second quarter. This slowdown was caused by a rapid contraction in the demand for residential investment: Following growth of still 4 percent in real terms quarter-on-quarter at the end of 2005, this demand component declined at an accelerated pace over the year 2006 until reaching a good -5 percent compared with the previous quarter in the fourth quarter. Private consumption was once more the key driver of economic activity, advancing by 1.0 percent in real terms from the previous period in the fourth quarter. Due to the weak dollar, exports performed strongly late in the year (+2 percent in real terms), while imports declined.

The ISM Purchasing Managers' Index – an important leading indicator of US economic development – has been falling since mid-2006. By contrast, the two indices for consumer confidence (released by the University of Michigan and the Conference Board) do not yet indicate a contraction in consumer spending, but rather even a slight pickup since mid-2006.

Following a slight moderation in the third quarter (+0.6 percent quarter-on-quarter), economic expansion in the EU 27 and EU 25, respectively, again accelerated to +0.9 percent at the end of the year, hence clearly outpacing growth in the USA. For the year 2006 as a whole, real GDP growth thus stood at around 3 percent, with expansion in the euro area (both excluding and including Slovenia) probably only slightly lower.

Notably industrial production once more expanded at a vigorous pace towards the end of the year (month-on-month rate of growth in the euro area +1 percent in December and +0.3 in November). In year-on-year terms, the rate was even as high as +4 percent (+2.7 percent in November). The month-on-month increase was particularly high in France and Italy. In the EU, the industrial confidence indicator remained at its high level also in January, suggesting that the favourable development will continue.

Although exports were the key driver of economic growth in 2006, the EU-area trade balance deteriorated significantly compared with 2005, falling to -8.2 billion euro in 2006 from a surplus of 16.2 billion euro in 2005. The increase in energy prices meant an additional burden of around 60 billion euro.

USA: Flatter growth due to investment decline

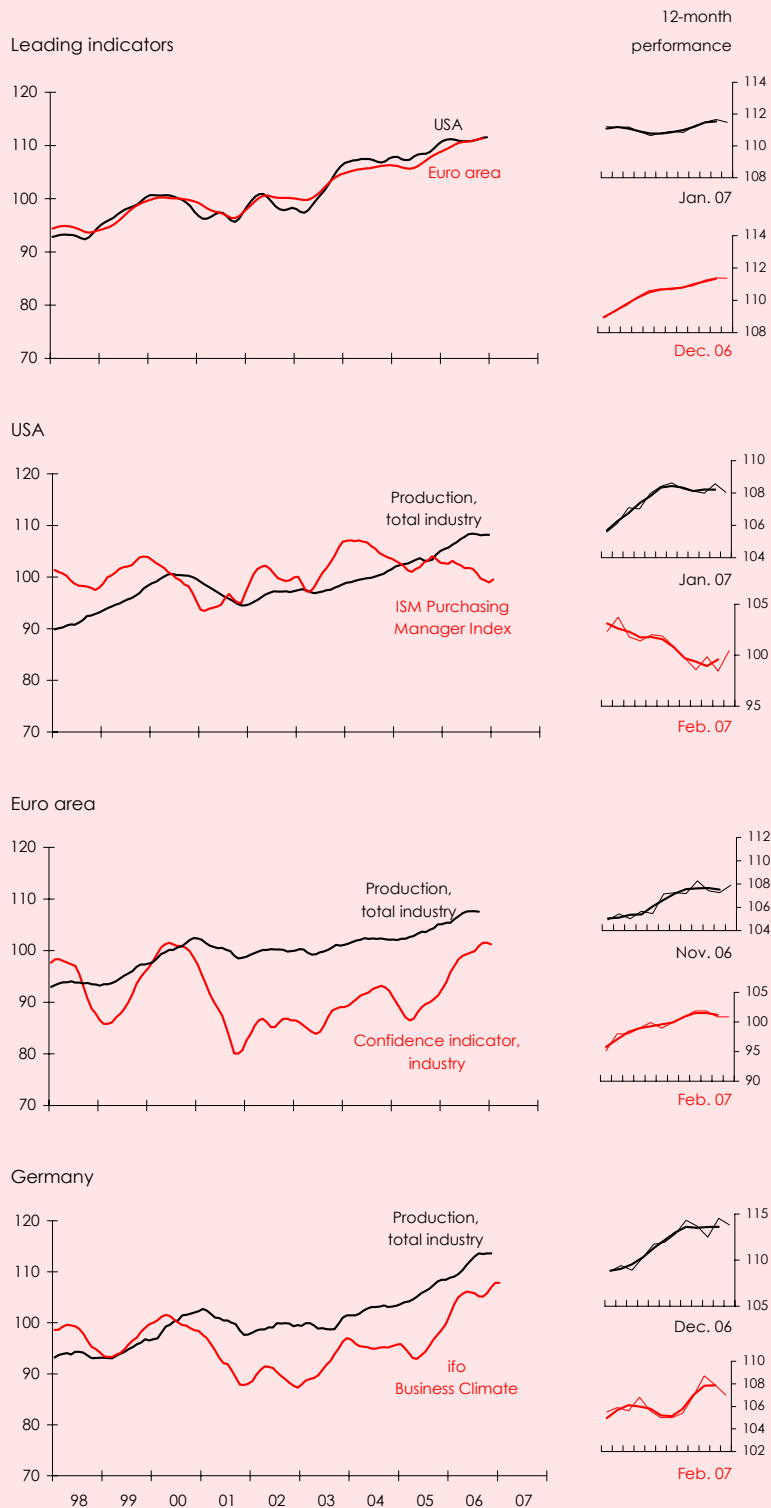
Following the moderation in growth observed since mid-2006, economic indicators in the USA point to continued expansion. However, a further slowdown of this in the near future cannot be ruled out.

Continued vigorous growth of EU economy

The economic situation in the EU is favourable. Unemployment can be reduced thanks to output growth. At the same time, inflation is declining.

Figure 2: International business climate

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



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

So far the buoyant economy has not sent inflation spiralling, possibly owing to lower crude oil prices and the strong Euro. But it appears that the key role here is played by the moderate wage growth, which is unusually weak given the momentum of the current economic upswing. Factors causing this wage restraint are a high com-

petitive pressure and still high unemployment numbers. As a consequence, companies can meet their increased demand for labour without having to pay higher wages.

Inflation in the euro area – unlike in previous phases of an economic upturn – is declining. The inflation rate as measured by the harmonised index of consumer prices has been below the threshold of 2 percent set by the ECB as consistent with price stability since October. In January, the annual inflation rate fell to 1.8 percent, from 1.9 percent in December 2006. In month-on-month terms, inflation dropped by 0.5 percent in January. The decline in oil prices has recently been brought to a halt by the latest speculation about a US military intervention in Iran.

The excellent economic situation in the EU has also had repercussions on the labour market. In January, the harmonised unemployment rate fell in 20 of the 27 EU member countries and remained unchanged in one country. Austria, with a harmonised unemployment rate of 4.5 percent, recorded the lowest rate after Denmark, the Netherlands, Estonia and Ireland.

2006, with real GDP advancing at a year-on-year rate of growth of 2.7 percent (2.9 percent adjusted for the different number of working days), went extremely well for the German economy. This was the highest growth rate since 2000. Growth was fuelled by brisk external demand, but investment provided the biggest boost: Gross fixed investment posted the strongest gain since reunification. Investment spending on machinery and equipment expanded at a rate of 7.3 percent in real terms, and construction investment, which had been subdued for more than a decade, for the first time again also posted a substantial increase (+4.2 percent). The most unfavourable performance was once more recorded for private consumption: Although its pace of growth accelerated to +0.8 percent in real terms, this demand aggregate once more did not support economic activity but dampened growth.

In the fourth quarter, economic growth accelerated significantly to a rate of +0.9 percent quarter-on-quarter, probably also owing to carry-forward effects before the increase in the value-added-tax rate at the beginning of 2007. Notably car purchases increased markedly before falling due to an echo effect at the beginning of 2007. This will subtract from growth in the first quarter of 2007; companies continue to judge the economic situation very favourably, though.

The Ifo Business Climate Index, while declining somewhat in February, still remains at an extremely high level. Companies gave somewhat less optimistic assessments of both their business expectations and their current business situation. The unfavourable assessment of the business situation in retailing, which is weakening the overall result, is not due to the economic situation, however, as this partial index is to a large extent influenced by the carry-forward effect. Manufacturing firms judged the current situation somewhat more positively than in January.

Consumer demand by German households remains a weak point of the economic development. Wage growth has been very moderate in spite of the good performance of the economy. But here too, certain indicators give some ground for confidence: On the one hand, inflation continues to be very low, which benefits real income developments; on the other hand, the situation on the labour market is improving steadily. The harmonised unemployment rate, which in January 2006 still amounted to 9 percent, stood at just 7.7 percent at the beginning of 2007. Even in the event that hourly wages rise hardly at all, employment gains will nevertheless raise the total wage bill; this should strengthen consumer demand. The ongoing upward movement of the consumer confidence indicator observed in January also signals a possible pickup in consumer demand.

The Austrian economy, like the EU economy, developed very dynamically in 2006. Real GDP growth for the year 2006 as a whole was 3.2 percent, despite two working days less compared with the previous year. Growth eased temporarily towards the end of the year. Both exports and the demand for investment exhibited strong mo-

German economy remains robust

The fourth quarter of 2006 saw economic growth in Germany strengthen significantly, also owing to carry-forward effects; as a counter reaction those probably weigh on growth at the beginning of 2007. Economic activity nevertheless remains robust.

Boom continues in Austria

mentum in 2006. Consumer demand by private households, while expanding at a faster pace than in previous years, lagged behind the overall economy in terms of growth. As in Germany, wage growth was moderate, with household spending consequently remaining lacklustre.

Retail sales continued to recover in 2006. According to Statistics Austria, sales rose by 1.7 percent in real terms in 2006 after an increase by 1.5 percent in 2005. This is the highest growth rate since 2000 and is comparable to that of a beginning economic upturn. Signs of an accelerated growth in household consumption are still lacking, however. After the weak results of last year, the number of newly licensed cars stagnated during the first two months of 2007. The favourable results of consumer surveys, on the other hand, possibly portend an imminent pickup in consumer demand. The most recent survey shows a clear increase in the consumer confidence indicator. This time the increase was not limited to the partial index for the assessment of the general economic situation, but also extended to the indicators for the assessment by consumers of their own financial situation and for intended larger-scale purchases in the coming months.

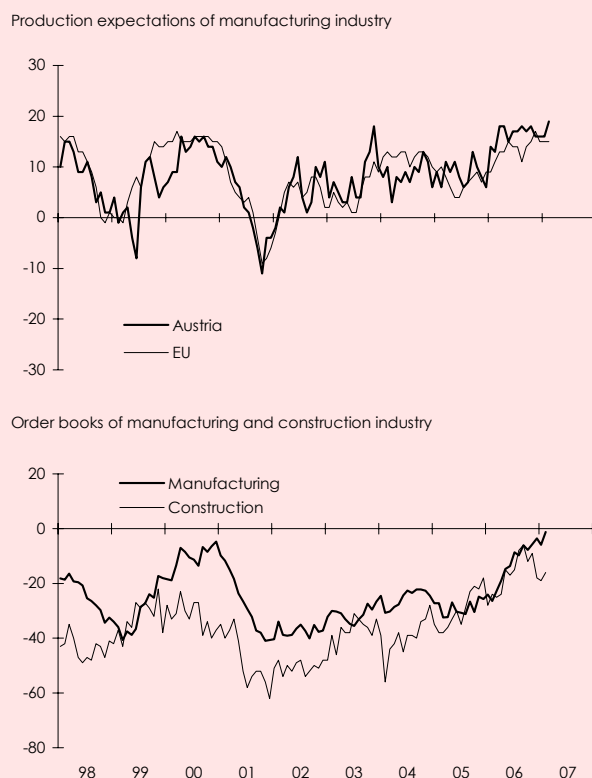
The WIFO business survey for February reflects the persistent optimism prevailing among Austrian companies. Firms in manufacturing reported their best order situation in ten years, with notably manufacturers of capital goods posting a marked rise in order levels since the previous survey. This is only in part attributable to foreign orders – the pickup in investment by domestic companies also encourages this development. A gradual improvement in order levels can also be observed in the production of durable goods.

Business surveys suggest a continuation of the boom in Austria. Investments are expected to become the main driver of growth in 2007, and consumer survey results also give some ground for optimism.

Booming industrial activity permits massive expansion of employment in manufacturing.

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.

Production expectations for the next three months darkened somewhat in the second half of 2006. But in February 2007 they again reached the extremely high level held in the first half of 2006. The assessment of the business situation in six months

hardly changed compared with January, with the slight downward trend observed in recent months continuing.

Following years of job cuts, employment growth in manufacturing gathered speed owing to the strong demand for industrial products. The number of new jobs, which had been growing steadily since mid-2006, increased at an accelerated pace in January 2007.

While 2006 was an extremely successful year for Austria's construction industry, companies have been registering a slight decline in order levels since last autumn. The current situation is excellent, probably also owing to the mild weather. The high demand for construction investment is benefiting both building construction and civil engineering, with employment again expanding vigorously in January (by more than +16,000) after high gains in previous months. In the WIFO business survey conducted in February, firms in the construction sector were very sceptical regarding the outlook for a further increase in employment numbers. But they anticipate yet another significant rise in construction prices, extending the brisk advance in 2006 (+2.9 percent in building construction and +2.5 percent in civil engineering, according to Statistics Austria).

The moderation in construction activity in 2007 is in line with the expectations of the WIFO forecast of December 2006: Following an expansion in construction investment by a good 4½ percent in real terms in 2006, growth will slow down to less than 4 percent in 2007.

In the latest WIFO investment survey, firms in manufacturing and construction stated their intention to significantly increase their investment compared with last year (around +20 percent). The demand for investment had already accelerated noticeably last year. Real gross fixed investment for the year 2006 as a whole rose by 4¾ percent, with the growth momentum relatively stable over the course of the year.

As can be expected in the given economic situation, companies stated the expansion of capacities to be their main investment motive. This confirms the results of the WIFO business survey, suggesting that notably manufacturers of capital goods registered a significant rise in order volumes.

2006 was a particularly successful year for Austria's export sector. Exports rose by 12.7 percent, according to foreign trade statistics, with deliveries to third countries at +15.3 percent expanding at a faster pace than those to EU-countries (+11.5 percent). Total imports rose by 10.8 percent, making for a deficit of € 0.16 billion and thus a trade balance practically in equilibrium.

Exports grew at a vigorous pace in year-on-year terms also in December (+10 percent). However, the rate of change of the seasonally adjusted figures from the quarterly national accounts vis-à-vis the previous quarter fell gradually from +2.7 percent in the first quarter to +2.0 percent in the third quarter. Exports regained some momentum (+2.3 percent) towards the end of the year.

While lively internal economic activity in the EU will accelerate exports noticeably also this year, the demand from third countries – notably the USA – will grow at a slower pace. Imports, on the other hand, will also exceed the year-earlier level significantly owing to the brisk demand for investment, and will thus weigh on the trade balance.

The winter season has been a success up to now, in spite of only meagre snowfalls. The number of overnight stays, at 24.8 million from November 2006 to January 2007 again reached last year's peak level. Sales increased slightly in nominal terms (+1.5 percent).

Construction sector benefiting from brisk demand and mild weather

Construction firms continue to have well-filled order books and have added a substantial number of jobs in recent months. The mild weather has benefited construction activity in the first quarter, but some moderation in growth is likely.

Investment is the mainstay of economic activity in 2007

Both the WIFO business survey and the latest WIFO investment survey confirm the current brisk demand for capital goods.

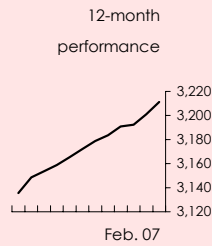
Lively export activity gradually slowing

International demand, a main driver of economic growth in Austria in 2006, is moderating due to the slow-down in economic activity overseas.

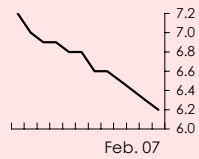
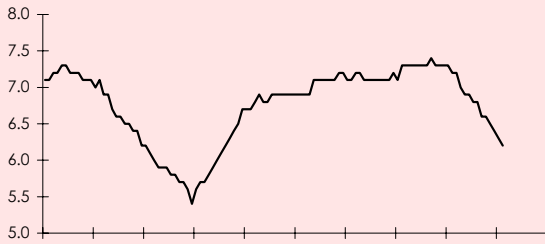
Tourism: good winter season despite unfavourable weather

Figure 4: Key Economic Indicators

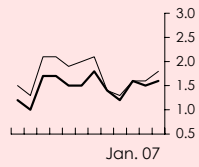
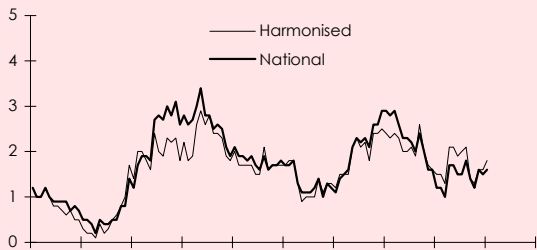
Persons in active dependent employment¹, (1,000), seasonally adjusted



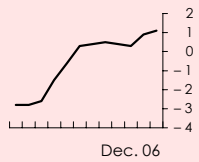
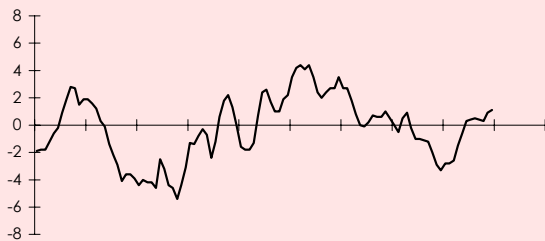
Unemployment rate, traditional Austrian method², seasonally adjusted



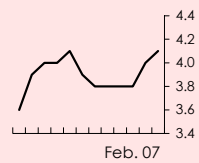
Consumer prices, year-to-year percentage changes



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 Office.

The number of overnight stays by guests from Great Britain, the Netherlands, Switzerland, France and the USA increased markedly, while that by visitors from Germany declined significantly. January saw a decline in overnight stays vis-à-vis last year notably by travellers from Austria as well as Italy and Germany.

An increase in sales volumes was posted in particular by those federal provinces where tourist trade is not dependent on snow conditions, such as Burgenland, Lower Austria and Vienna. But sales volumes outpaced year-earlier levels also in Upper Austria, Salzburg and Carinthia, while stagnating in Tyrol and Styria and declining in Vorarlberg.

Tourism posted an equally good result in the first half of the winter season as last year, despite only meagre snowfalls.

In January, headline inflation was 1.6 percent, almost unchanged from the previous month (1.5 percent). Despite an extremely buoyant economy, inflation up to now has not been found to be accelerating. This can be attributed only to a minor extent to the easing in the price of crude oil products observed since mid-2006 and the appreciation of the Euro. The partial index "transport" in January exceeded the year-earlier reading by 0.6 percent, while the item "housing, water, energy" accelerated by as much as 5.4 percent (electricity and gas +11 percent). By contrast, the price development of "clothing and footwear" (-3.4 percent) had a clearly dampening effect. According to Statistics Austria, this may reflect the relatively early beginning of the winter sale due to the mild weather. The partial index "recreation and culture" also exhibited a price decline (-0.7 percent).

Inflation remains low

After the surge in crude oil prices on international markets had come to a halt, inflation dropped markedly below 2 percent. The buoyant economy up to now has not been reflected in mounting inflationary pressures.

The harmonised index of consumer prices rose by +1.8 percent in January, somewhat more strongly than the national index. Hence the inflation rate measured according to this method was in line with the euro-area average.

The number of persons in dependent active employment in February advanced by almost 79,000 from a year earlier; the growth rate of 2.6 percent was the highest in 16 years. This extremely good result is in part also attributable to the mild winter weather. Thus employment in the construction sector in January exceeded the year-earlier level by 8.7 percent. New jobs were also created in sectors responsive to cyclical trends such as manufacturing (+2.4 percent) and business services (+7.3 percent), which also comprise manpower for hire.

Labour market improving markedly

Employment is reacting noticeably to the economic rebound, with unemployment receding further.

Due to the lively demand for labour it was possible to markedly reduce unemployment once more in spite of the ongoing expansion of the labour supply. In February, 35,000 fewer persons than last year (-11 percent) were registered as unemployed with AMS ('Public Employment Office'). Given the simultaneous growth in employment numbers, this decline constitutes a sizeable reduction in the unemployment rate: According to the national method of calculation it stood at 7.8 percent in February, a drop by 1.1 percent from February 2006. The rate calculated according to the Eurostat method also declined (0.1 percentage point month-on-month).