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# Stabilisation of Global Economy in Sight

## Business Cycle Report of August 2009

**The global economic situation eased in the second quarter of 2009, following the strong contraction in the second half of 2008. The USA and the eurozone saw GDP shrink at a markedly slower pace than in the two preceding quarters. The Austrian economy also contracted by a mere 0.4 percent in real terms quarter-on-quarter in the second quarter of 2009 (after –2.7 percent in the first quarter). Business surveys suggest the situation will improve further during the third quarter. Global economic conditions are nevertheless likely to remain fragile for a protracted period of time. Excess capacity, high unemployment rates and the problems faced by the financial sector dampen the prospects for a quick lasting recovery and will lead to a sequence of positive and negative news in the coming weeks.**

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According to WIFO's flash estimate of the quarterly national accounts, Austrian GDP shrank at a seasonally and working day adjusted quarterly rate of 0.4 percent in the second quarter, compared with a decline of still 2.7 percent in the first quarter of 2008. Hence, economic output in the second quarter was down by 4.4 percent from a year earlier (first quarter –4.7 percent).

This mainly reflects the beginning stabilisation of the global economy over the course of the second quarter. Although world trade and economic activity in industrialised countries continued their decline, the latter was comparatively small after the collapse experienced in the second half of 2008. In the USA, GDP fell by 0.3 percent quarter-on-quarter in the second quarter of 2009 (first quarter –1.6 percent); in the euro area, it shrank by 0.1 percent (first quarter –2.5 percent). Germany, which had been particularly affected by the sharp fall in industrial activity, actually saw GDP rise by 0.3 percent (first quarter –3.5 percent).

Most surveys suggest a further stabilisation in global industrial activity in the third quarter. Notably firms' production expectations and the assessment of inventory levels have steadily improved in recent months. Inventory adjustment was a significant factor in the decline in world trade in the second half of 2008. The last two quarters saw a worldwide rundown of inventories that had accumulated in the autumn of 2008 as a consequence of the surprise decline in sales. This process, which particularly weakened the demand for intermediate and capital goods, is likely to have progressed sufficiently far. Hence, production should stabilise further as inventory levels normalise.

While the prospects for a recovery of the global economy in the second half of 2009 are improving, one must not overlook the difficulties still standing in the way of a lasting upswing over the medium term. High unemployment rates and the high indebtedness of private households in the USA and the UK are likely to dampen the rebound in consumer demand; this cannot be lastingly compensated for by high state deficits. The recent setback in consumer confidence after its recovery in the second quarter demonstrates the fragility of private consumption in the USA. Moreover, corporate financing conditions are likely to remain difficult given the low production levels and the problems faced by the financial sector. This may hamper the recovery of investment activity. Finally, further turbulences in financial markets and hidden risks in the banking sector cannot be entirely excluded.

Table 1: Flash estimates of quarterly national accounts

	2008				2009	
	First quarter	Second quarter	Third quarter	Fourth quarter	First quarter	Second quarter
Adjusted for seasonal and working day effects, percentage changes from previous quarter, volume						
<i>GDP, expenditure approach</i>						
Final consumption expenditure						
Households <sup>1</sup>	+ 0.2	+ 0.1	+ 0.1	+ 0.1	+ 0.1	+ 0.4
General government	- 1.0	+ 2.6	- 0.7	+ 1.4	+ 0.2	- 0.1
Gross capital formation	+ 0.7	+ 0.7	+ 0.7	- 14.9	+ 0.7	- 3.2
Gross fixed capital formation	+ 0.2	- 0.2	- 1.1	- 1.7	- 1.8	- 1.4
Exports	+ 1.4	- 1.9	- 3.5	- 5.6	- 5.7	- 1.1
Imports	- 0.6	- 0.2	- 3.0	- 4.0	- 3.8	- 0.2
Gross domestic product	+ 1.0	+ 0.5	- 0.3	- 1.0	- 2.7	- 0.4
<i>GDP, output approach</i>						
Agriculture, forestry	+ 1.5	- 0.3	- 1.6	- 0.6	- 2.8	+ 3.0
Industry, including energy	+ 2.3	+ 2.0	- 0.5	- 2.6	- 8.0	- 2.8
Manufacturing	+ 3.1	+ 1.3	- 0.7	- 2.7	- 9.8	- 3.0
Construction	+ 0.7	+ 0.4	- 0.4	- 3.3	- 2.0	- 1.0
Wholesale and retail trade; repairs; hotels and restaurants; transport, communication	+ 0.4	- 0.0	- 0.6	- 1.9	- 2.7	- 0.0
Financial intermediation; real estate, renting and business activities	+ 0.7	+ 0.7	+ 0.2	- 0.3	- 1.3	- 0.2
Other service activities	+ 0.6	+ 0.5	+ 0.4	+ 0.7	+ 0.4	+ 0.4
Taxes on products	+ 0.5	+ 0.4	- 0.9	- 0.8	- 1.3	+ 0.2
Subsidies on products	+ 3.0	+ 2.1	+ 0.3	- 1.1	- 2.5	- 1.6
Percentage changes from previous year						
Gross domestic product, volume	+ 3.4	+ 3.0	+ 2.3	- 0.3	- 4.7	- 4.4

Source: WIFO. – <sup>1</sup> Including private non-profit institutions serving households.

Consistent with the global economic situation, Austrian exports of goods and services also stabilised in the second quarter (-1.1 percent, compared with -5.7 percent in the first quarter). The demand for capital goods and car parts remained subdued, however. As these goods make up a large portion of Austrian exports, this may have been one of the reasons – together with developments in some East European countries – for the somewhat stronger decline in GDP in Austria (-0.4 percent) in the second quarter compared with the euro area as a whole (-0.1 percent). On a year-on-year basis, GDP contraction in Austria (-4.4 percent) was slightly below the euro area average (-4.6 percent) and substantially smaller than in Germany (-5.9 percent). Private consumption rose by 0.4 percent in the second quarter (first quarter +0.1 percent), supported by the entry into force of the tax reform and the car-scrapping scheme. Given the high import content of car sales, the increase in new car registrations in the second quarter had only a moderately positive effect on Austrian GDP, though. Gross fixed capital formation, by contrast, shrank further in the second quarter (-1.4 percent, first quarter -1.8 percent), owing to excess capacity.

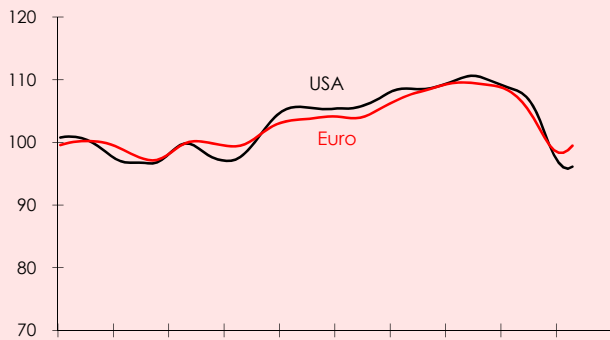
WIFO's July business cycle survey shows an increasing stabilisation of new orders and improving production expectations also for Austria. Conditions in the Austrian labour market, which traditionally reacts with a lag to cyclical developments, continued to deteriorate in the second quarter. On a seasonally adjusted basis, employment fell by 0.7 percent compared with the previous quarter (first quarter -0.7 percent). The seasonally adjusted unemployment rate (according to the Austrian definition) stood at 7.4 percent in July, an increase by 1.6 percentage points from a year before.

The negative inflation rates (Austria July -0.3 percent, USA June -1.4 percent, euro area July -0.7 percent) mainly reflect the fall in the high energy and food prices since last year. For this reason the consumer price indices excluding energy and food are currently better indicators of medium-term inflation developments. In June, the inflation rate of this index stood at 1.7 percent in the USA. In July, the rate of inflation excluding energy and unprocessed food was 1.2 percent in the euro area and 1.4 percent in Austria.

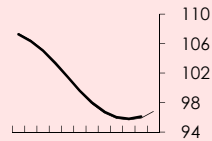
Figure 1: International business climate

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

Leading indicators



12-month performance

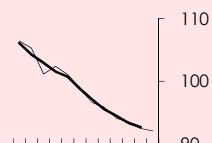
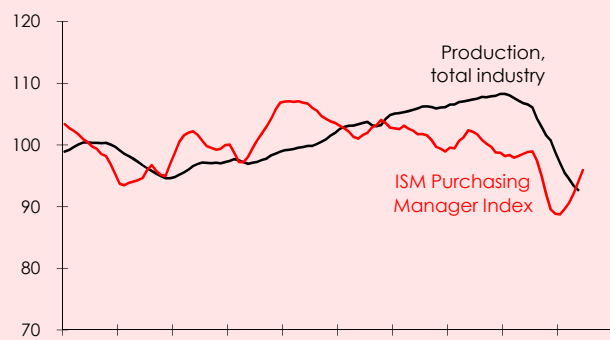


May

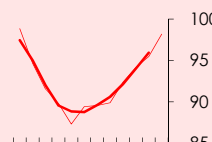


May

USA

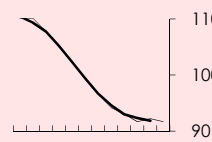
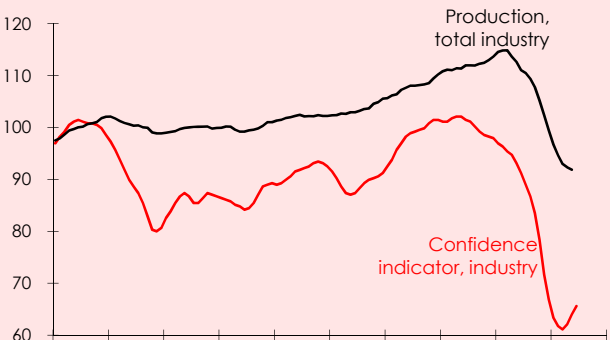


June



July

Euro area

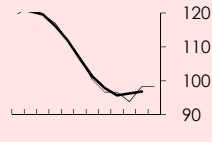
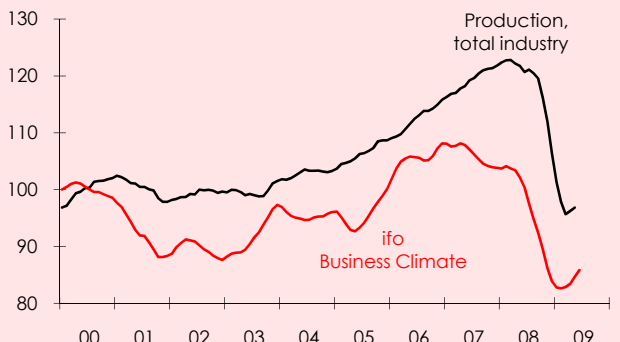


June

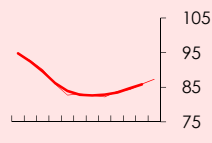


July

Germany



June



July

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

The pace of the global economic downturn slowed noticeably in the second quarter of 2009. US real GDP contracted at a seasonally adjusted quarter-on-quarter rate of just 0.3 percent, after declines of around  $-1\frac{1}{2}$  percent in the two preceding quarters. The corporate sector is showing clear signs of a rebound. Private gross fixed investment, at  $-3.6$  percent fell at a markedly slower pace than in the previous quarter ( $-11.6$  percent). Inventories contributed only  $-0.2$  percentage point to growth, after  $-0.6$  percentage point in the first quarter – another sign that inventory levels are normalising. Exports also fell by merely 1.8 percent in real terms (first quarter  $-8.5$  percent).

In the USA, the massive fiscal packages brought about a rise in household real disposable income in the first half of 2009 (first quarter  $+0.3$  percent, second quarter  $+0.8$  percent), despite the decline in GDP. At the same time the household saving rate rose briskly to 5.2 percent, after 1.2 percent at the beginning of 2008. Hence, private consumption fell again in the second quarter, by 0.3 percent quarter-on-quarter (first quarter  $+0.2$  percent).

At  $-0.1$  percent, euro area GDP also contracted much more slowly quarter-on-quarter in the second quarter than in the first ( $-2.5$  percent). Both Germany and France saw GDP grow by 0.3 percent, while most EU countries registered a small decline. In Great Britain, GDP fell by 0.8 percent (first quarter  $-2.4$  percent). The new EU countries save Poland and Hungary registered a higher-than-average contraction in GDP.

According to evidence presented in business surveys, the prospects for global industrial activity in the second half of 2009 are largely positive. The OECD's composite leading indicators for the USA and the euro area, for instance, suggest that the downturn in industry may have bottomed out in the second quarter. The US Purchasing Managers' Index rose once more in July, and at 48.9 percent recently stood only marginally below the 50-percent threshold that is indicative of expansion (June 44.8 percent). The surveys conducted by the European Commission also show a brightening of business sentiment in the euro area. Production expectations and the assessment of inventory levels have been improving steadily since March. Unlike in the USA, however, assessments here remain well below their long-term averages. The results reflect a normalisation in inventory levels and some stabilisation of production; order books, by contrast, have not improved as yet. The assessment of capacity utilisation also was only marginally more positive in July than in April.

Unemployment continued to rise throughout the world in the second quarter. Most recently, the seasonally adjusted unemployment rate for both the USA and the euro area stood at  $9\frac{1}{2}$  percent. In the USA, the rate has thus more than doubled from the record low seen in 2007. Consumer confidence, while stagnating in the USA in June and July following its strong rise in spring, has improved steadily since March in the euro area.

The future prospects for the global economy largely depend on how fast private consumption in the USA and Great Britain will recover in the face of tight labour markets and high household indebtedness. The fragility of private consumption becomes apparent, among other things, in the slight decline in consumer confidence in the USA yet again in July and August, following its rebound in the second quarter. The increase in the saving rate of private households in the USA and Great Britain reflects the necessary consolidation of their finances. Up to now the former has for the most part been financed through an expansion of net government transfers. Since August, the USA has also been providing funds for a car-scrapping premium for buyers of new cars (\$ 3 billion), which should give additional support to consumption during the second half of the year. In both countries, the government deficit is expected to reach about 12 percent of GDP in 2009.

The drop in commodity prices has dampened inflation rates throughout the world. In the second quarter, the HWWI Index of World Market Prices of Commodities excluding energy in euro terms stood 24 percent below its year-earlier level; it has, however, again been following an upward trend since March.

## Signs of stabilisation in global economy

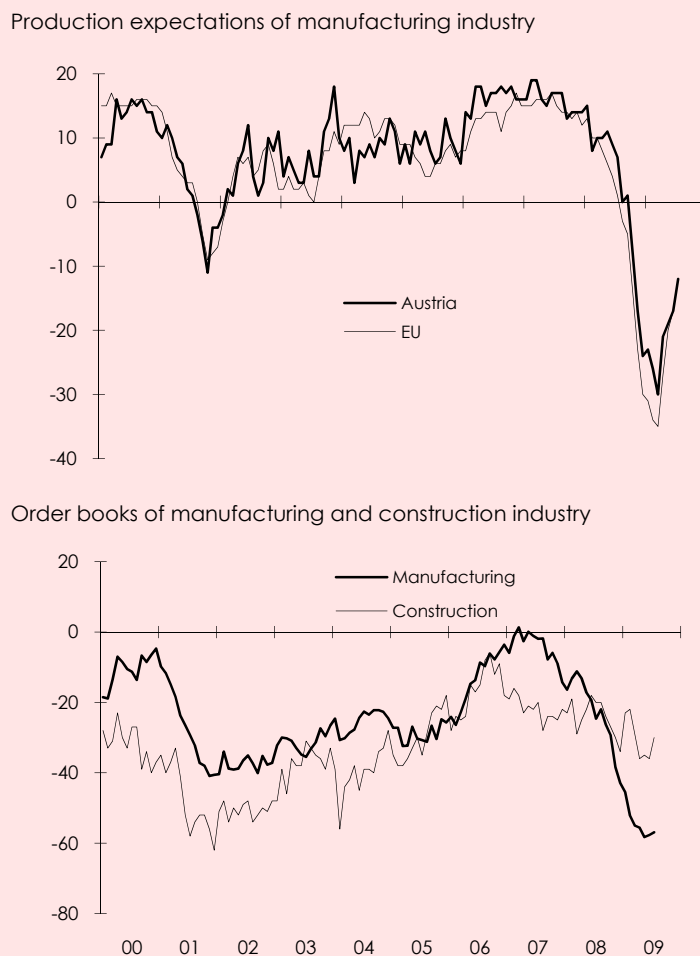
*The pace of the global economic downturn slowed substantially in the second quarter of 2009. Inventory levels largely normalised, thereby setting off a stabilisation in production and world trade. However, high unemployment rates and difficult financing conditions remain a risk to recovery.*

In June, the sharp year-on-year decline in crude oil prices was reflected in OECD countries in a negative inflation rate of  $-0.1$  percent (USA  $-1.4$  percent, euro area July  $-0.7$  percent). Crude oil prices have again been rising markedly since the beginning of the year, however, so that last year's high prices will cease to have an effect this autumn. Then the negative contribution from energy prices to inflation will be reversed.

Currently inflation excluding energy and food may well be a better indicator of inflation trends for the economy at large. In June it averaged  $1.7$  percent in OECD countries (USA  $1.7$  percent), a slight decline from the peak of  $2.5$  percent recorded in September 2008. In the euro area, inflation excluding energy and unprocessed food stood at  $1.2$  percent in July.

Figure 2: 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.

The Austrian economy contracted by  $0.4$  percent in real terms (seasonally and working day adjusted) in the second quarter of 2009, compared with the previous quarter, according to WIFO's latest flash estimate (first quarter  $-2.7$  percent). Compared with the same quarter of the previous year, GDP was down by  $4.4$  percent in the second quarter.

A positive contribution to growth was provided by private consumption: it rose by  $0.4$  percent (seasonally and working day adjusted) in the second quarter (first quarter  $+0.1$  percent). Consumption benefited greatly from the implementation of the tax reform and the car-scrapping scheme as of 1 April. Net retail sales (excluding

**Private consumption  
driver of Austrian  
economy in the  
second quarter**

motor vehicles) remained stable also in the second quarter; on a price-adjusted basis, they were largely unchanged from last year in the first five months of 2009. New car registrations rose by 7.2 percent year-on-year in the second quarter, following a decline of 12.9 percent in the first quarter. The car-scrapping premium may have dampened new car sales in the first quarter as potential buyers put off purchases until its entry into force; consequently, the increase was all the stronger in the second quarter. Given the high import content of car sales, the increase in new car registrations in the second quarter had only a moderately positive effect on Austrian GDP.

In line with the global situation, demand in the export-oriented sectors largely stabilised in the second quarter. Exports of goods and services fell by 1.1 percent, compared with the previous quarter, markedly less than in the first quarter of 2009 (-5.7 percent). Imports of goods and services decreased by 0.2 percent in the second quarter (first quarter -3.8 percent).

Gross fixed capital formation remained weak in the second quarter, owing to excess capacity and difficult financing conditions. It declined by 1.4 percent quarter-on-quarter (first quarter -1.8 percent). Investment in machinery and equipment, at -2.3 percent, was affected somewhat more strongly than construction investment (-1.2 percent).

Value added in manufacturing still fell by 3.0 percent quarter-on-quarter in the second quarter (first quarter -9.8 percent), whereas at  $\pm 0,0$  percent it remained stable in the services sectors trade, accommodation services and transport (first quarter -2.7 percent). At -1.0 percent, the decline posted by the construction industry in the second quarter was smaller than in the two previous quarters (first quarter -2.0 percent, fourth quarter of 2008 -3.3 percent).

Consistent with the surveys for the euro area, WIFO's business cycle survey indicates a further easing of the situation in June, with firms' production expectations improving markedly overall in June and July. Nevertheless, the proportion of firms expecting the business situation to remain poor over the coming months still exceeds that of firms anticipating an upward trend.

However, according to the evidence presented in the survey, firms do not yet assess current production more positively. The proportion of firms declaring order book levels to be "insufficient" is still as high as in April (60 percent). In the motor vehicle industry, more than 80 percent of the firms are experiencing a lack of orders. The average capacity utilisation rate was 73 percent in June, the same as in April.

Business services firms also assess their six-month business outlook more positively. But the majority of firms still expect demand to fall.

In construction, order book levels have improved in the civil engineering sector, most likely owing to the expansion of public investment, but have remained low in building construction. The majority of firms in both sectors expect building prices to fall and plan workforce reductions.

According to provisional calculations, tourism sales shrank by 5.1 percent in May and June 2009, compared with the same period a year before. A similar decline was recorded in the number of overnight stays (-5.5 percent).

Although the results are somewhat distorted by last year's high levels and the bad weather in June, developments clearly show that Austria's tourism sector, as expected, cannot evade the impact of the financial and economic crisis. In May and June 2009, foreign demand dropped sharply compared with a year earlier (-8.5 percent), while domestic travellers contributed somewhat to a stabilisation of the overall result (May and June 2009 +0.1 percent). The negative trend is likely to persist over the remainder of the year.

In the first third of the 2009 summer season, sales picked up marginally only in Burgenland and Styria (+0.2 percent year-on-year) and in Upper Austria (+0.1 percent), while they fell substantially in some of the other federal provinces; in Lower Austria and Vorarlberg they were below trend, though.

*Austrian GDP shrank by 0.4 percent quarter-on-quarter in the second quarter of 2009. The tax reform and the car-scrapping premium enabled robust consumption growth, while the export-oriented sectors benefited from stabilising global economic activity.*

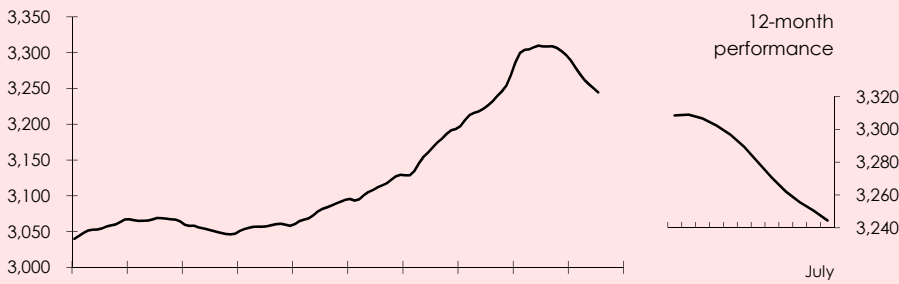
## Industry and services sector less pessimistic in July

## Tourism decline continues

*Declining global consumer demand hit tourism in early summer.*

Figure 3: Key economic indicators

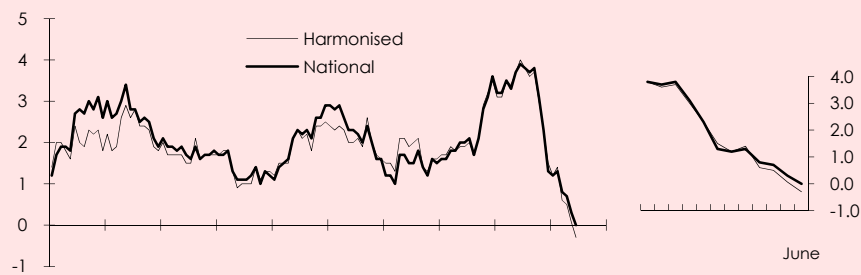
Persons in active dependent employment<sup>1</sup>, (1,000), seasonally adjusted



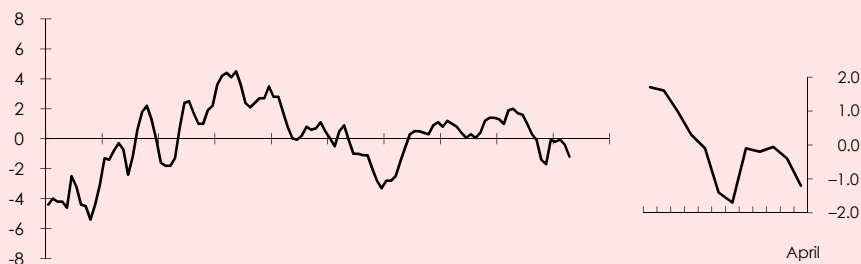
Unemployment rate, traditional Austrian method<sup>2</sup>, seasonally adjusted



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. –<sup>1</sup> Excluding parental leave, military service, and unemployed persons in training. –<sup>2</sup> As a percentage of total labour force excluding self employed, according to Public Employment Service.

The labour market generally reacts to cyclical fluctuations with a lag of several months. Consequently, the situation deteriorated further in July. The number of persons in dependent active employment was down by 1.9 percent (-64,700) from a year before, and declined by 0.2 percent compared with the previous month (June -0.2 percent). The seasonally adjusted figures show a decline of 0.7 percent for both the first and the second quarter of 2009.

Unemployment increased further. In June, 232,400 persons in all were registered as unemployed, an increase by 53,700 compared with a year before (+30.1 percent). The seasonally adjusted unemployment rate according to the Austrian method of calculation rose to 7.4 percent in July (June 7.3 percent) and consequently was just close to 1 percentage point higher than at the beginning of the year.

## Labour market deteriorating further

### 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, this is referred to as "seasonally and working day adjusted changes".

The phrase "changed compared with a year before . . .", on the other hand, describes a relative 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.

#### 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.

#### 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 (<http://www.statistik.at/>).

#### 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.ikt.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".

At the same time, the number of job vacancies has kept declining. In July, it was down by 31.6 percent from last year. The seasonally adjusted figures, at -2.9 percent



show a somewhat slower month-on-month decline for July than for the preceding months (around  $-3\frac{1}{2}$  percent since the beginning of the year). Whether or not this is the beginning of a stabilisation cannot be judged yet. According to WIFO's business cycle survey, about one third of manufacturers believe they will have to reduce their workforce in the foreseeable future, whereas only 5 percent of the firms envisage the possibility of hiring new staff.

In Austria, inflation as measured by the consumer price index stood at  $-0.3$  percent in July. The harmonised inflation rate (HICP) was  $-0.4$  percent in July. Hence, the price decline was somewhat smaller than the euro area average ( $-0.7$  percent).

This development is consistent with expectations and is mainly attributable to crude oil price developments: after peaking at around \$ 144 per barrel in mid-July 2008, prices descended continuously, to \$ 35 in December 2008, and rose again thereafter to around \$ 70 at present. Consequently, the price index of the expenditure category "transport" in June stood 6.8 percent below its year-earlier level. The decline will persist only until the autumn of 2009, however. Thereafter, energy prices will again make a positive contribution to the inflation rate.

CPI inflation excluding energy and unprocessed food was 1.4 percent in July, 0.6 percentage points lower than at the beginning of the year. Meanwhile, weak demand is being reflected appreciably in wholesale prices, which generally react distinctly faster and more strongly than consumer prices to demand fluctuations. In July, the wholesale price index was 11.5 percent below its year-earlier level.

### **Inflation dipping briefly into negative territory**

*The negative inflation rate in July was mainly attributable to the decline in fuel prices. Excluding the price effects of energy and unprocessed food, inflation stood at 1.4 percent in July.*