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Economic Downturn in Austria Still Restrained

Business Cycle Report of February 2019

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The trade conflict between the USA and China is increasingly weighing on the global economy. In the USA, the government shutdown dampened the optimism of private households. The German economy is still suffering from the upheavals in the automotive sector. The Austrian economy is proving to be robust in view of the global burdens. Here as well, however, the majority of indicators point to a downturn.

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JEL-Codes: E32, E66 • **Keywords:** Business Cycle Report

All staff members of the Austrian Institute of Economic Research contribute to the Business Cycle Report. For definitions used see "Methodological Notes and Short Glossary", <https://www.wifo.ac.at/wwadocs/form/WIFO-BusinessCycleInformation-Glossary.pdf> • Cut-off date: 7 February 2019.

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ISSN 1605-4709 • © Austrian Institute of Economic Research 2019

Impressum: Herausgeber: Christoph Badelt • Chefredakteur: Michael Böheim (michael.boeheim@wifo.ac.at) • Redaktionsteam: Tamara Fellingner, Ilse Schulz, Tatjana Weber • Medieninhaber (Verleger) und Redaktion: Österreichisches Institut für Wirtschaftsforschung • 1030 Wien, Arsenal, Objekt 20 • Tel. (+43 1) 798 26 01-0 • Fax (+43 1) 798 93 86 • <http://bulletin.wifo.ac.at> • Verlags- und Herstellungsort: Wien

The global economy has recently lost momentum. Having been the driving force behind the global upswing, the Chinese economy is now the major flaw in the global economy. The trade dispute between the USA and China, which only had an impact on the financial markets in 2018, is increasingly affecting the real economy. As survey results show, these negative economic impulses will continue to intensify in the coming months. In the USA, the government shutdown recently dampened consumer sentiment. However, there is no direct GDP effect as the salaries of those on forced leave are paid in arrears. Overall, the economic outlook for the USA has deteriorated, and the central bank will refrain from further interest rate hikes for the time being.

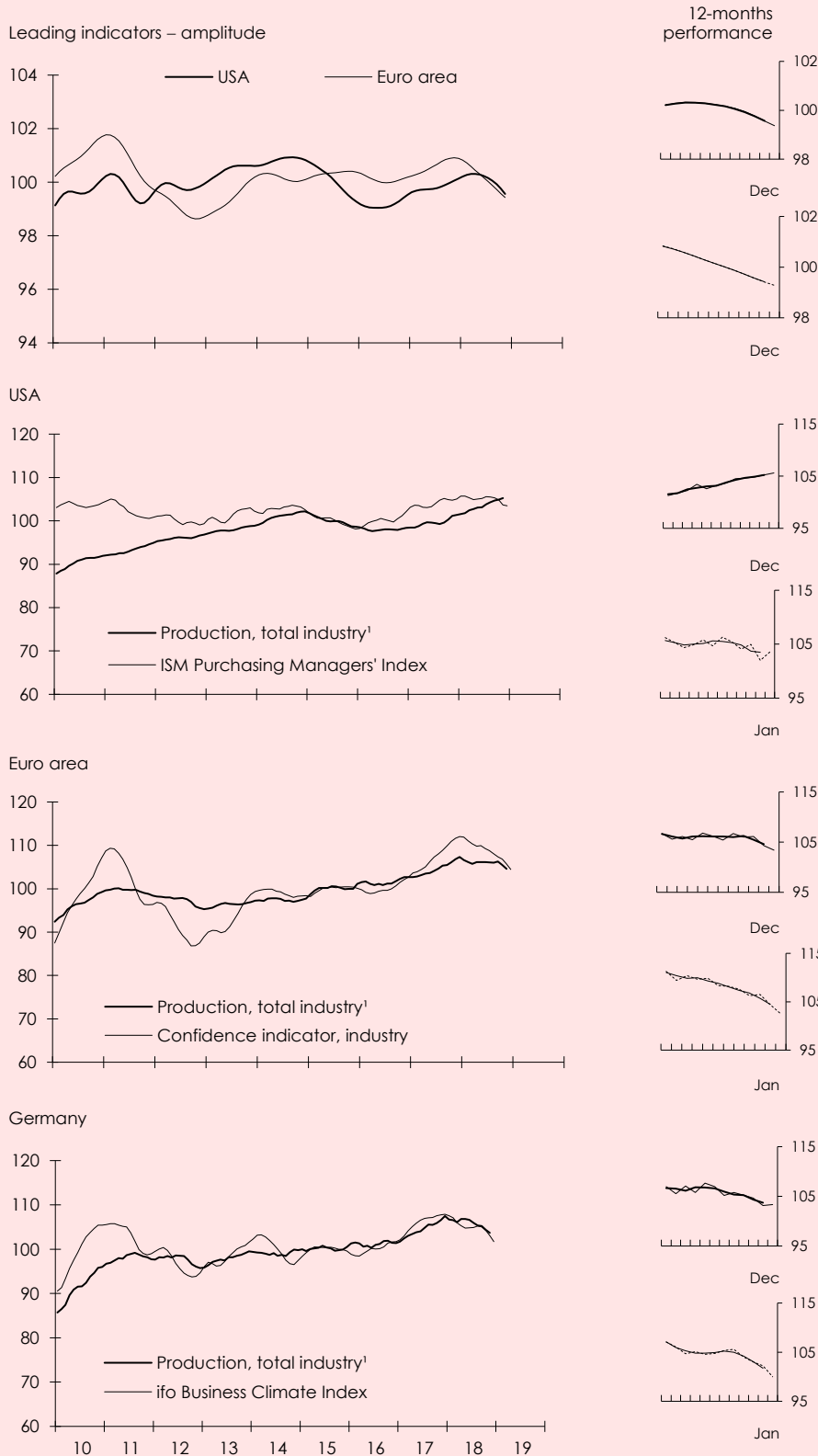
The slowdown in world trade activity is also weakening the EU economy. In addition, the German automotive industry has not yet recovered from the distortions caused by insufficient preparation for new methods of measuring exhaust emissions. The economies in France and Spain, but also in Austria, have developed more favourably recently. The economic momentum here has so far slowed only moderately, and capacity utilisation is still above average. Similar to Germany, however, domestic industrial companies are hardly confident for the coming months. The decline in unemployment faltered at the beginning of 2019, especially among risk groups such as older people, who in any case had only benefitted late from the economic upswing. Conversely, the number of vacancies, usually an early indicator of the economic trend, rose sharply again. The economic signals are therefore mixed, but the majority point to a downturn.

Meanwhile, the European Court of Justice has ruled that the denomination-specific working time regulation in Austria on Good Friday is discriminatory and therefore null and void. If Parliament does not act, Good Friday will no longer be a working day. The effect on value added is cyclical, seasonal and sector-dependent; the average for the economy as a whole and at normal capacity utilisation is around -0.1 percent.

For this year, WIFO expects a dampening of GDP and, as a result, of corporate profits of around 400 to 600 million €. This corresponds to 10 to 15 percent of the costs of per capita wage increases in 2018.

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.

1. Downturn in China weighs on global economy

The world trade boom that supported the growth of the global economy in 2017 and 2018 seems to be over. Leading indicators signal a slowdown in the annual growth rate of world trade to around 2 percent (2017 and early 2018 +6 percent). Signs of stabilisation have recently been observed, however. Global investment indicators are also trending downwards. A survey-based indicator for the G 3 (USA, Japan, Germany), which anticipates the actual development of incoming orders by around three months, recently collapsed. In December 2018, China's exports in dollar terms shrank by 4.5 percent year-on-year and imports by 7.3 percent. Imports from Asia and the G 7 to China, which had grown by just under 20 percent a year ago, remained 8 to 9 percent below the previous year's level. The Chinese Purchasing Managers' Index for the export sector, which anticipates the actual development of exports by around six months, fell in December to its lowest level since mid-2016. This indicator situation reflects the increasing impact of the trade dispute between the USA and China on the real economy.

The trade dispute between the USA and China is having increasingly negative real effects.

2. Economic situation in Venezuela facing further setback

The political recognition of the opposition leader Juan Guaidó as interim president of Venezuela by a growing number of American and European countries, including the USA and many EU countries, has more and more economic consequences. The British central bank, for example, rejected the Venezuelan central bank's request to withdraw 1.2 billion \$ in gold reserves. The USA require Guaidó to be recognized as president for transactions with Venezuelan state-owned companies. Venezuela's state assets, which fall under US jurisdiction, are likely to be frozen. This would tantamount to an oil embargo and further reduce crude oil production, which is already severely restricted by the government's mismanagement. In view of Venezuela's high dependence on the USA as a buyer of crude oil, the economic crisis in Venezuela will worsen further.

3. Government shutdown damps consumer sentiment in the USA

Since no decision on the state budget was reached in the USA, around 350,000 to 375,000 public employees were furloughed from 22 December 2018 to 25 January 2019 as a result of the "shutdown", i.e. the partial closure of the public administration. About 400,000 more employees, who provide vital or other indispensable services, were temporarily forced to continue to work free of charge. However, a new law stipulates that all those affected must be remunerated retroactively. Thus, the direct statistical effect of the shutdown on value added is eliminated, as that of the public sector is calculated on the basis of salaries paid. Possible indirect effects include a dampening of private consumption and the impairment of other sectors which were restricted in their productivity by the forced renunciation of the use of public services. Consumer confidence cooled temporarily markedly as a result of the shutdown. Within two months, the Conference Board's Index fell by nearly 12 percent and the University of Michigan's Index by 6 percent. As similar episodes in the past, such as the government shutdown in 2013, show, consumer confidence is recovering after the shutdown.

The "shutdown" of federal government operations and agencies in the USA is depressing consumer sentiment. As salaries are paid in arrears, however, it has no direct negative effects on GDP.

4. Central bank of the USA indicates moderation of interest rate policy

The monetary policy decision-making body of the US central bank signalled at its last meeting that it would not raise interest rates for several months: The wording that there would be "further gradual increases in the target range" and that the economic risks would be "roughly balanced" no longer appear in the Committees' report. The monetary policy situation in the USA is therefore similar to that of early 2016, when the diagnosis of balanced cyclical risks was removed from the report. Before that the

central bank had raised interest rates for the first time in December 2015, after which the global economy had clouded over. It was not until September 2016 that the FOMC described the economic risks as balanced again; in December 2016 it then continued to raise interest rates. Since then, the lower limit of the federal funds target range has been raised gradually from 0.5 to 2.25 percent every few months; the last increase took place in December 2018.

At its first meeting in 2019, the Governing Council of the ECB, which is responsible for monetary policy in the euro area, also stated that the downside risks to the economic outlook had increased. The members of the Governing Council agreed on the risks and their effects, but the permanence of the negative factors could only be assessed after a certain period of time. Therefore, no immediate monetary policy measures were taken, but the likelihood of new expansionary measures in the near term has increased.

The ECB is also increasingly stressing the downside risks for the economy.

5. Further deterioration of sentiment in German industry

The first economic surveys for Germany in 2019 reinforce the unfavourable outlook for Europe's largest economy. At 99.1 points in January, the ifo-index was around 2 points below the December level and was at its lowest level since the beginning of 2016. Both the assessment of the current framework conditions and business expectations declined, the latter even dropping to their lowest level in around seven years. In addition, the ifo export climate fell significantly again in January.

In the euro area as a whole, the mood with regard to economic development continued to deteriorate, although not in all economic sectors. Confidence increased in the construction industry, with the indicator just below its previous high. Consumer confidence also increased. The strongest negative impetus came from industry, which dominates the index: the confidence index fell to its lowest level for more than two years. Sentiment also deteriorated in the retail and the service sector.

The picture was mixed in the individual countries: in Germany and Italy the subjective assessment clouded over. In the fourth quarter of 2018, Italian economic output contracted by 0.2 percent compared with the previous quarter, after also declining in the third quarter. In France, on the other hand, confidence in economic development increased, especially consumer confidence. Sentiment also brightened in the service sector. In France, the economy grew by 0.3 percent in the fourth quarter of 2018 compared with the previous period, it thus reacted only slightly to the adverse effects of the protests of the "gilets jaunes". The confidence indicator also improved slightly in Spain, with economic growth accelerating to +0.7 percent in the fourth quarter compared with the previous quarter.

While economic optimism is clouding over in German manufacturing, consumer sentiment in France is improving despite protests against the government.

6. Austria: economic downturn so far mild

In the fourth quarter of 2018, Austrian GDP grew by 0.4 percent seasonally adjusted compared to the previous period (trend-cycle component) and by 2.3 percent compared to the previous year. According to these flash estimates, real GDP in 2018 exceeded the previous year's level by 2.7 percent. The Austrian economy expanded stably towards the end of 2018, but more slowly than in the first half of the year. The production of goods stagnated, and the momentum in the retail sector also weakened. The economy was supported by the construction sector, the tourism industry and other business services.

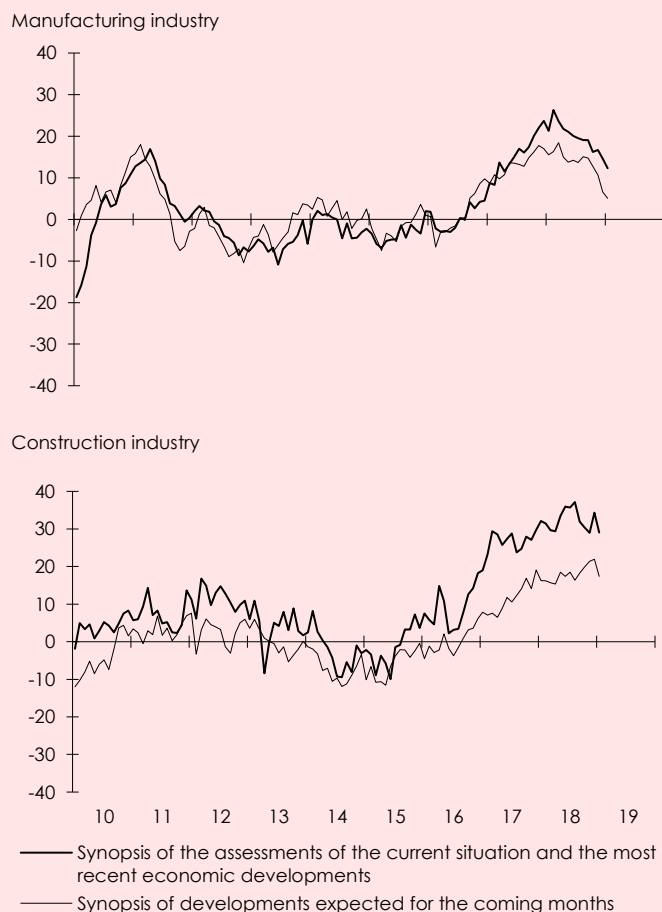
The WIFO-Konjunkturtest (business cycle survey) of January 2019 revealed a further deterioration in economic assessments by Austrian companies. Starting from a high level, they assessed the current economic situation as somewhat less favourable than in previous months, and expectations deteriorated. In the construction industry, the expectation index declined, but remained at a very high level. It picked up somewhat in the service sectors, while the index of expectations for the manufacturing sector fell further and was only just in the confident range. Capacity utilisation, however, was still exceptionally high at 86 percent. As the most important barriers to production were

Industrial companies in Austria are hardly confident any more.

named a shortage of labour supply (around 20 percent) and material and capacity (around 10 percent). 60 percent of the companies reported no barriers to production, 9 percent a lack of demand.

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.

6.1 Record result in tourism with strong growth rates in Vienna

After the number of overnight stays and arrivals had risen further in the summer of 2018, Austrian tourism also recorded significant growth in demand in the winter pre-season. The previous highs from 2017 were again exceeded between November and December 2018 (guest arrivals +5.6 percent, overnight stays +7.6 percent, nominal tourism revenues +7.3 percent). The number of overnight stays by international guests grew much more strongly than that from Austria (+10.0 percent, overnight stays by domestic guests +1.8 percent). In Vienna, tourism revenues expanded significantly (+18 percent in nominal terms). The winter pre-season was also above average in Carinthia. Demand was less favourable in Styria and Burgenland. The increases in the alpine federal countries Tyrol, Vorarlberg and Salzburg are remarkable, as the snow conditions remained below the long-term average. The average length of stay increased by 1.9 percent to 2.9 overnight stays per guest. The long-standing trend towards shorter but more frequent trips was thus interrupted for the first time since 2013. It remains to be seen whether this is already a trend reversal.

6.2 Pressure on fuel prices eases

Consumer prices rose by 1.9 percent in December. Prices increased strongly again in the two sectors that have been causing above-average inflation in Austria for several

years: gastronomy (catering services +2.9 percent) and housing (rents paid +3.4 percent). In addition, the cost of transport services rose again (operation of private transport equipment +4.0 percent). However, the price increase in this area flattens out after having reached its peak in October 2018 due to the small oil price shock (in the run-up to the Iran sanctions) where the price of operating private transport equipment temporarily increased by 8 percent. Together, the categories "transport", "housing, water, energy" and "restaurants and hotels" contributed more than half (1.1 percentage points) to the headline inflation rate in December.

6.3 Stalling decline in unemployment

The decline in unemployment slowed down in January, while the decline in the number of people in training accelerated. The seasonally adjusted unemployment rate was 7.4 percent, unadjusted 9.0 percent. After unemployment had fallen by more than 6 percent per month compared to the previous year until December, the January figure (368,000) was only 3 percent or around 11,000 below the previous year's level. Around 66,000 people were seasonally unemployed. Unemployment among people over 50 years of age and among persons with health impairments even increased. These overlapping groups of people, on the other hand, had only benefitted from the upswing late on: the decline in unemployment did not begin until October 2017 and January 2018, respectively, when the economic peak had already been reached. The number of long-term unemployed as another risk group still declined in January, albeit at a slower pace. The signals for young workers remain positive, however: youth unemployment fell again and is now already lower than in January 2008 during the last boom phase. The employment expansion continued in January nearly unabated; seasonally adjusted it amounted to 0.2 percent compared to the previous month and 2.0 percent compared to the previous year. Correspondingly, the number of job vacancies expanded swiftly, and the seasonally adjusted number of unemployed per job vacancy fell below 4.

Unemployment has already risen somewhat among risk groups.

6.4 Discriminatory Good Friday regulation abolished

The European Court of Justice has annulled the previous working time regulation for Good Friday because it favoured members of certain denominations over the rest of the population. If no legislative measures were taken, Good Friday would in future be free of work for all employees, provided they apply for it from the employer. The introduction of an additional day off would reduce Austrian value added by up to 0.2 percent, depending on the economic situation. In the industry, which is decisive for the overall economic working day effect, capacity utilisation plays an important role: more value added is lost during a boom than during under-utilisation. In both 2017 and 2012, there were two fewer working days than in the respective previous years. This reduced value added by less than 0.1 percent (or 0.05 percent per working day) during the economic slack in 2012, whereas it fell by almost 0.4 percent (or 0.2 percent per working day) during the boom in 2017. Moreover, in the construction sector seasonal aspects must be taken into account: construction operations are less affected by the introduction of an additional public holiday in winter than in the building season. In the service sector, too, per capita labour costs will rise as a result of an additional holiday, but businesses in the hotel and restaurant industry could benefit from an increase in demand.

The economic effects of introducing an additional holiday depend on the economic situation and the season.

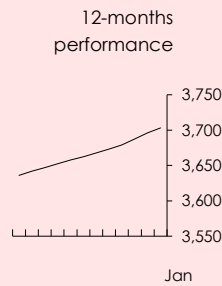
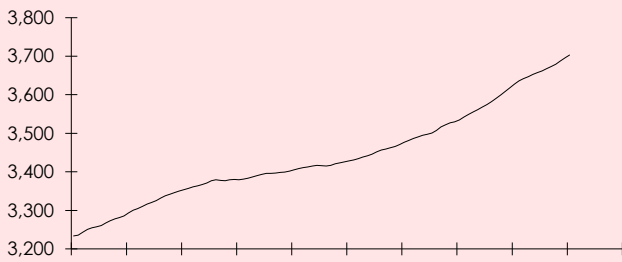
On a long-term average, the introduction of an additional holiday reduces the value added of the economy as a whole by 0.1 percent. This marginal production effect accounts for only a quarter of the average production per day (at 250 working days per year) due to the declining marginal returns of production: remaining work is made up on other days where possible, and employees are better rested and more productive after days off. Moreover, in the case of Good Friday, the working day effect is somewhat lower because some sections of the population have already had time off, either ex lege (which has now been recognised as discriminatory) or through company agreements. In 2019, the introduction of a Good Friday holiday should reduce value added and corporate profits by around 400 to 600 million €, assuming a GDP of around 400 billion € and above-average capacity utilisation. This would correspond

The introduction of Good Friday as a public holiday would reduce GDP by about 400 to 600 million € this year.

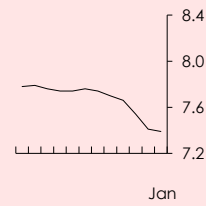
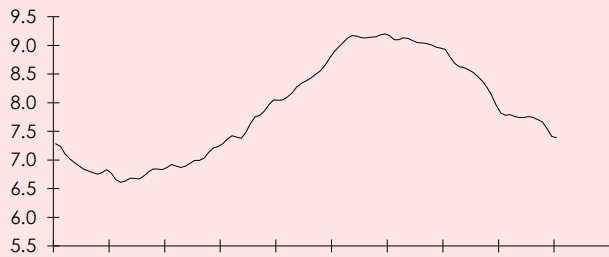
to around 10 to 15 percent of the costs incurred by companies as a result of the effective per capita wage increases in 2018.

Figure 3: Key economic indicators

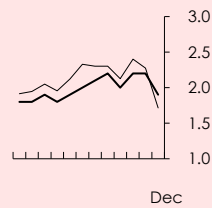
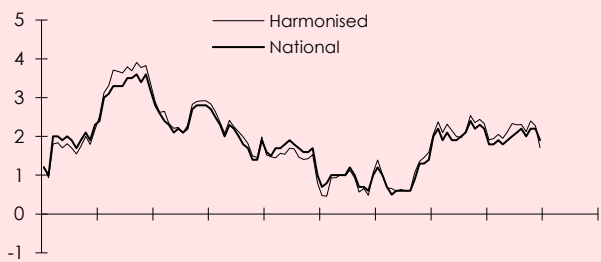
Persons in active dependent employment¹, 1,000s, seasonally adjusted



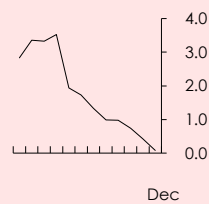
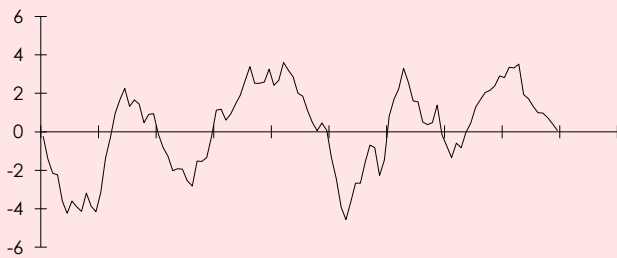
Unemployment rate, traditional Austrian method², seasonally adjusted



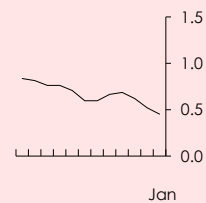
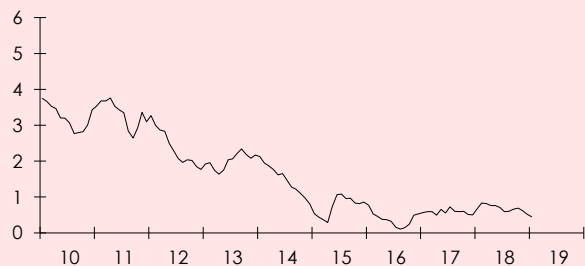
Consumer prices, year-to-year percentage changes



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.