

Sandra Bilek-Steindl

Recovery Continuing

Business Cycle Report of February 2014

Recovery Continuing. Business Cycle Report of February 2014

Leading indicators suggest a slow recovery is under way for the Austrian and the EU economy. While notably firms in Austria's manufacturing sector have become more optimistic about the state of the economy, confidence among domestic consumers has cooled somewhat recently. Industrial activity picked up already in the fourth quarter of 2013, and the tourism industry has also been registering sales gains in the winter season so far.

Contact:

Sandra Bilek-Steindl: WIFO, Arsenal, Objekt 20, 1030 Vienna, Sandra.Bilek-Steindl@wifo.ac.at

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

For definitions of terms used, see "Methodological Notes and Short Glossary", <http://www.wifo.ac.at/wwadocs/form/WIFO-BusinessCycleInformation-Glossary.pdf> • All staff members of the Austrian Institute of Economic Research contribute to the Business Cycle Report. • Cut-off date: 10 February 2014

Data processing: Christine Kaufmann (Christine.Kaufmann@wifo.ac.at), Martha Steiner (Martha.Steiner@wifo.ac.at)

ISSN 1605-4709 • © Austrian Institute of Economic Research 2014

Impressum: Herausgeber: Karl Aiginger • 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

World trade and global industrial production expanded further at the end of 2013, with Asia's emerging market economies acting as the main drivers of growth. Other emerging economies such as Brazil or South Africa, by contrast, are experiencing an economic slowdown, which entails the risk of further capital outflows. China's economy has also expanded at a slower pace recently.

The US economy, by contrast, continued to grow briskly in the fourth quarter of 2013, but survey evidence points towards an uncertain outlook for the current quarter. The central bank announced that it would somewhat tighten its loose monetary policy in February and further reduce its monthly long-term Treasury bond purchases.

In the EU, signs that industrial activity is slowly recovering began to emerge already at the end of 2013. The latest leading indicators suggest the economy is gaining momentum. In Germany, where exports have been rising already since the autumn of 2013, business sentiment also improved noticeably in January, as evidenced by the Ifo Business Climate Index.

In Austria, too, the results from WIFO's latest Business Cycle Survey confirm the positive trend of business expectations. Notably Austrian manufacturers have assessed the situation much more positively recently. According to WIFO's Leading Indicator, the Austrian economy is expected to show an upward trend in the coming months.

Consumer sentiment, by contrast, continued to cool somewhat in January, reflecting consumers' ongoing reluctance in the fourth quarter to purchase durable consumer goods. Real retail sales (preliminary figures, excluding cars) declined in December. Positive stimulus meanwhile is being provided by tourism, with real sales increasing in the winter season so far.

The labour market shows barely any tendency to improve: the number of persons in dependent active employment increased again slightly in January (+0.1 percent, seasonally adjusted, compared with the previous month). At the same time the

number of unemployed persons also rose further: in January, 369,800 persons were registered as unemployed, an increase of 9.3 percent compared with January of the previous year. According to the Austrian method of calculation, the seasonally adjusted unemployment rate stood at 7.9 percent in January, unchanged from the previous month.

1. Momentum slowing in some emerging market economies

World trade is on a growth track. Its volume increased by 2.1 percent on a three-month-moving-average basis in November compared with the previous period. This was the highest growth rate recorded since February 2011. Recently this acceleration has been driven mainly by the export dynamics of Asia's emerging market economies, but exports from the USA and from East Central Europe have also increased more strongly.

Other big emerging economies such as Brazil or South Africa, by contrast, are experiencing an economic slowdown and further capital outflows. Some countries are trying to stem capital flight by raising key interest rates. Triggered by the monetary policy tightening in the USA, it is mainly structural factors such as excessive current account deficits that lead to the shifting of capital.

Growth in China also slowed moderately in the fourth quarter of 2013, with GDP expanding by 1.8 percent compared with the previous period (after +2.2 percent in the third quarter). At the beginning of 2014 leading indicators are signalling a sharper slowdown, however. The Manufacturing Purchasing Managers' Index (according to HSBC) fell for the first time in six months and now stands at 49.5 points. In 2013, the Chinese economy grew by 7.7 percent, equalling the rate achieved in 2012. These were the lowest growth rates recorded since 1999. Apart from the weakness of the global economy and hence of foreign demand observed in the last two years, the slowdown is being caused increasingly by structural changes (medium-term tertiarisation of the economy). In addition, the continuously growing real estate bubble and the massive expansion of shadow banking have heightened uncertainty in recent months.

Japan's economy continues to fare well. The Tankan leading indicators published by Japan's central bank signal a further improvement in economic activity. However, households are expected to bring forward some purchases in the current quarter in anticipation of the increase in the value added tax rate from 5 percent to 8 percent in April. The impact of this measure is to be cushioned by an economic stimulus programme as well as by expansionary monetary policy measures. The latter are being used by the central bank to combat long-standing deflation. The decline in prices may soon ebb; consumer prices rose by 1.6 percent in December compared with a year before, the seventh increase in a row, though mainly owing to higher prices of energy imports.

Growth of world trade and global industrial production has slightly accelerated again recently. The outflow of financing capital from some emerging market economies is continuing.

2. USA: robust GDP growth in fourth quarter

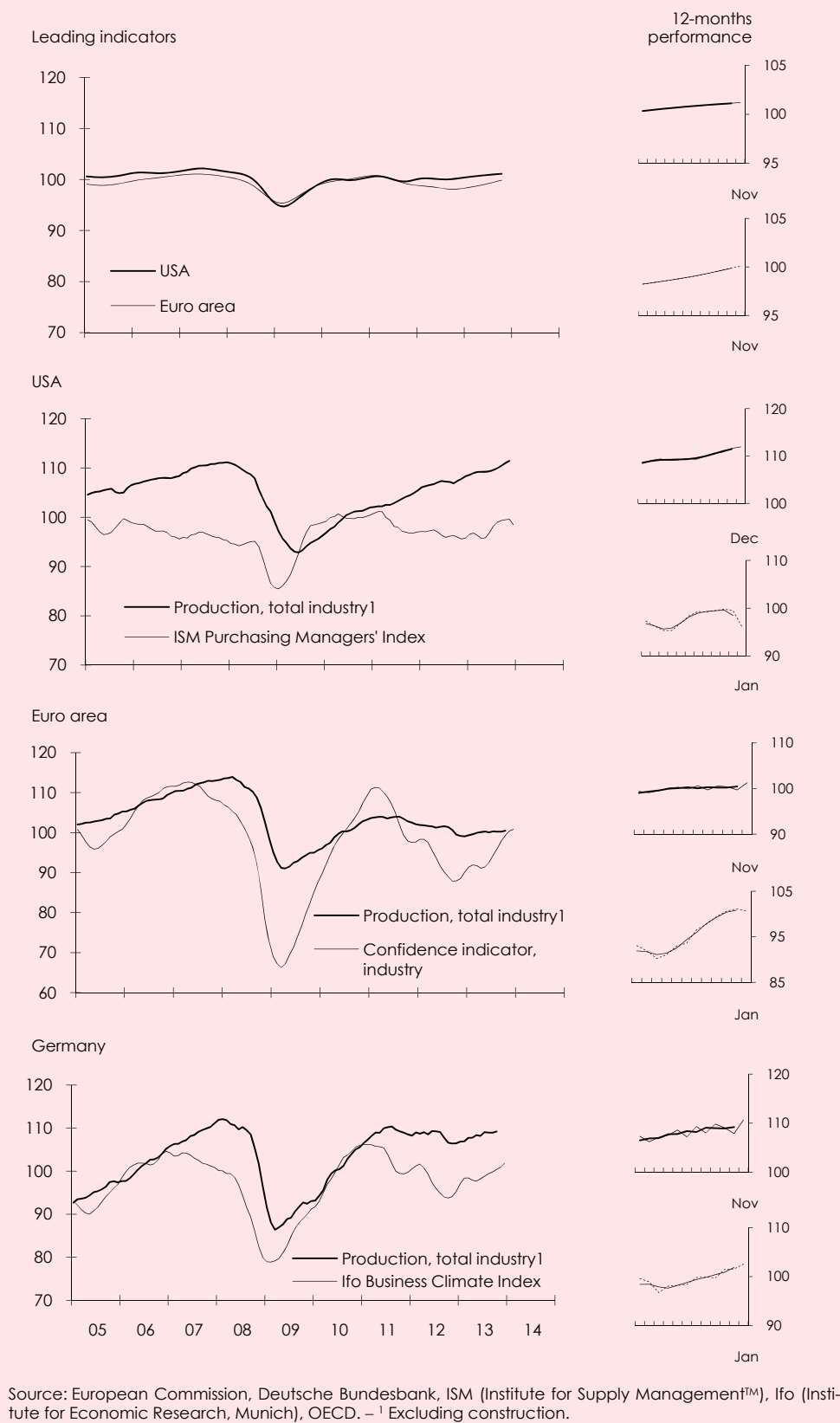
According to the first advance estimate, US GDP grew at a quarter-on-quarter rate of 0.8 percent in the fourth quarter, after +1.0 percent in the third quarter. Growth in the fourth quarter was driven especially by personal consumption expenditures and net exports. Fixed investment again increased more strongly as well. Due to the weaker momentum observed in the first half of the year, GDP growth for 2013 overall was 1.9 percent.

Industrial activity was also very buoyant in the second half of the year. Industrial production rose for the fifth consecutive time in December. At 79.2 percent, capacity utilisation was 1.8 percentage points above the year-earlier level in December. Following a period of weakness, it is thus approaching its long-term average (1972-2012) of 80.2 percent.

The US economy performed strongly in the second half of 2013, with notably industrial production providing strong stimulus. The Fed has begun to scale back its bond-buying programme.

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.

However, leading indicators point to uncertain developments in the first quarter of 2014. The Purchasing Managers' Index fell significantly – partly due to the weather – in January, but at 51.3 points indicates ongoing expansion. Contradictory signals have recently been sent by consumer surveys. According to the Conference Board,

consumer confidence rose further in January, while according to Reuters/University of Michigan it declined moderately.

The central bank began to wind down its loose monetary policy and announced to further lower its monthly long-term Treasury bond purchases in February. The key interest rates remained unchanged at between 0 to 0.25 percent. In principle the Fed stuck to its guidelines for its short-term interest rate policy according to which interest rates will not be raised as long as the seasonally adjusted unemployment rate exceeds 6.5 percent, but in addition now also takes inflation expectations into account. In December, the seasonally adjusted unemployment rate stood at 6.7 percent.

3. EU sees rebound in industrial activity

At the end of 2013 signs of a rebound in industrial activity emerged in the EU. Industrial production increased by 1.5 percent month-on-month in November (following -0.5 percent in October). Notably capital goods production, which is very sensitive to cyclical developments, grew vigorously. In January, the Economic Sentiment Indicator rose for the ninth consecutive time in both the euro area and the EU as a whole. Its development varied across regions: while the indicator rose in Germany, France, Poland and the UK, it declined in the Netherlands. Consumer confidence has also improved considerably recently. The indicator for the euro area again exceeded its long-term average for the first time since July 2011. Private households are more optimistic than recently about the expected general economic situation. Pessimism regarding the outlook for the labour market has declined noticeably, despite continuing high unemployment in several countries.

Labour market conditions began to stabilise very hesitantly in the second half of 2013: the seasonally adjusted unemployment rate averaged 10.7 percent in the EU in December 2013. This was the third time a moderate decline was registered that year (October and November 2013: 10.8 percent). Compared with December 2012, the seasonally adjusted unemployment rate increased in 14 of the 28 EU member countries, fell in 13, and was unchanged in Sweden. A sharp increase was registered in Cyprus (December 2013: 17.5 percent, December 2012: 13.9 percent) and Greece (October 2013: 27.8 percent, October 2012: 26.1 percent). The biggest drop was observed in Ireland (December 2013: 12.1 percent, December 2012: 14.0 percent) and Portugal (December 2013: 15.4 percent, December 2012: 17.3 percent).

The European Commission's Business Survey signals further improvement in economic conditions in both the EU as a whole and the euro area.

4. Commodity markets lack momentum

The HWWI Index of World Market Prices of Commodities, which comprises food, beverages and tobacco as well as energy and industrial raw materials, fell moderately in both dollar and euro terms in January. Energy prices in euro terms fell further compared with a year before. These price declines were to some extent passed on to consumers.

Euro area inflation as measured by the HICP fell to 0.8 percent in December 2013. According to Eurostat's flash estimate, inflation declined further to 0.7 percent in January. The sub-indices having the largest upward impacts on headline inflation in December were electricity and tobacco as well as restaurants and cafeterias. Fuels for personal transport equipment once again had a dampening effect. Price dynamics varied greatly across the individual countries of the euro area: while consumer prices fell sharply yet again in Greece (-1.8 percent) and Cyprus (-1.3 percent), above-average increases were registered in Estonia (2.0 percent), Austria (2.0 percent) and Finland (1.9 percent).

5. German businesses remain confident

The German economy grew by 0.4 percent in 2013. Following a weak start at the beginning of the year, economic activity recovered over the course of 2013. The

moderate expansion of the global economy and the ongoing recession in some European countries had a dampening effect on the export-driven manufacturing sector, with net exports consequently dragging down GDP growth by 0.3 percentage point in 2013. Overall, German exports dropped by 0.2 percent in 2013 compared with a year before. After a weak start at the beginning of 2013, they began to rise again in seasonally adjusted month-on-month terms in August 2013.

The Ifo Business Climate Index points to ongoing improvement in economic activity. Business confidence rose markedly in January, and firms' assessment of the current situation also brightened moderately.

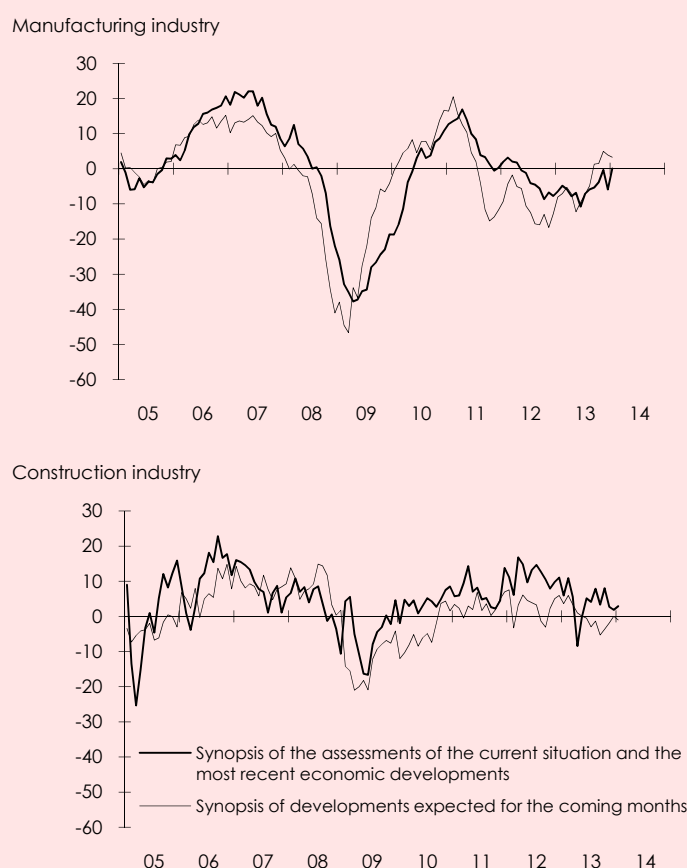
6. Austria: improved industrial activity

Weak global economic activity dampened exports also in Austria. Cumulative exports from January to November 2013 rose by a mere 1.0 percent, while cumulative January-November 2013 imports were down 2.0 percent compared with the same period a year before.

Austrian manufacturers were considerably more positive in their assessment of economic conditions in January. The picture is somewhat less optimistic for the economy as a whole.

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.

According to WIFO's Business Cycle Survey conducted in January 2014, manufacturers' assessment of economic conditions improved noticeably. In January, the index measuring manufacturers' assessment of the current situation rose to its highest level since April 2012; production expectations are as positive as last recorded in March 2012. Capacity utilisation stands at around 82 percent, slightly above its long-time average. For the first time in a year, manufacturers' assessment of their own

business situation is also positive on balance. Firms in the other sectors, however, have not been quite as positive in their assessment of the present situation recently: while the present situation index rose only moderately in the construction industry in January, it fell in the services sector.

WIFO's Leading Indicator remained largely unchanged in January compared with the previous month. Nevertheless, it points to ongoing recovery of the Austrian economy in 2014. Looking at its sub-components, the seasonally adjusted number of job vacancies decreased slightly in January. Production expectations in industry fell as well on a month-on-month basis (according to the European Commission's Business Survey). A positive contribution to WIFO's Leading Indicator came from the increase in Ifo's Business Climate Index as well as from the improvement in the ATX and Euro Stoxx 50 stock market indices.

6.1 Consumer sentiment cooling somewhat

Consumer confidence cooled somewhat in Austria in the last two months, as measured by the European Commission's Consumer Confidence Indicator. Pessimistic appraisals continued to predominate in the January survey, with consumers' more unfavourable assessment of their personal financial situation and of developments of the general economic situation over the next 12 months playing a decisive part. This was also reflected at the end of 2013 in consumers' ongoing reluctance to purchase durable consumer goods (such as cars or furniture). The increase in new passenger car registrations by private households by around 8 percent in December is likely also attributable to households' bringing forward some purchases in anticipation of the change of NoVA (duty on fuel consumption under standard conditions) scheduled for 1 March 2014. Overall, new passenger car registrations were down 5.1 percent in 2013 compared with a year before.

In December 2013, retail sales (excluding cars) were somewhat higher in nominal terms than a year before, but adjusted for price effects they were lower, according to provisional calculations by Statistics Austria. Food retailers increased their sales in both nominal and real terms from a year before, whereas the other sectors registered a decline during the 2013 Christmas season.

6.2 Sales gains in tourism

Nominal tourism sales rose by 2.8 percent (real sales +1.2 percent) year-on-year in the first two months of the 2013-14 winter season, according to preliminary calculations. The decline in real expenditure per night spent by 2.7 percent reflects the fact that guests are becoming increasingly savings-minded. This is also apparent in the highly dynamic development of nights spent in low-cost accommodation (commercial holiday apartments +12.3 percent, private holiday homes and apartments +7.0 percent). But at the same time 4&5 Star hotels also recorded high increases (+4.3 percent).

The number of overnight stays rose by 4.0 percent overall in November and December 2013 compared with the same period a year before. This result was largely attributable to the expansive demand from abroad (+5.0 percent), while the number of nights spent by resident guests increased only moderately (+1.5 percent).

International demand expanded in almost all of the important source markets in the first two months of the 2013-14 winter season, especially from the USA (+12.7 percent), Russia (+10.4 percent) and Poland (+9.0 percent), while nights spent by travelers from the Czech Republic, Romania and France stagnated. Substantial declines were noticeable only in the Italian market (-5.6 percent).

6.3 Pickup in inflation in December

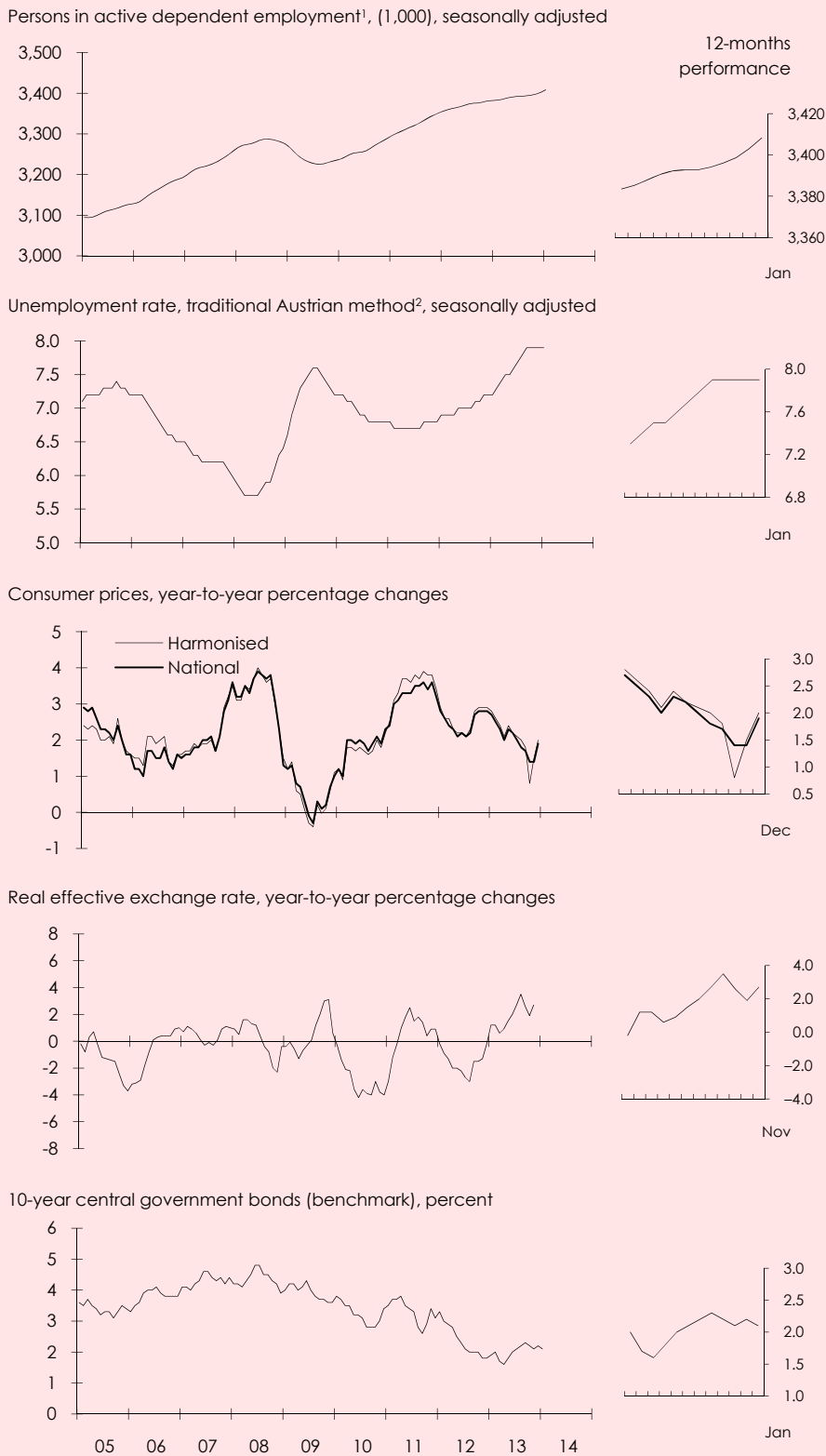
The inflation rate (CPI) averaged 2.0 percent in 2013 and was thus consistent with the average for the years 2001 through 2010. After easing to 1.4 percent in October and November 2013, inflation picked up in December (1.9 percent, HICP +2.0 percent). In addition to the persistently high price dynamics in the housing, water, energy and food components, this development was driven by price increases for clothing and accommodation services. At the same time fuel prices no longer fell as

The winter tourist season started with sales gains. Notably the number of overnight stays by foreign guests increased vigorously.

Inflation accelerated in December. Especially sharp price increases continued to be recorded for housing, water, energy and food.

sharply as of late. Excluding price increases for housing and food, inflation would have stood at only 1.2 percent.

Figure 3: Key economic indicators



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.

Real estate prices stabilised in 2013. Following two-digit growth rates in 2012, the Residential Property Price Index for Austria as a whole of the Austrian National Bank and the Vienna University of Technology rose by a mere 4.1 percent in the fourth quarter. A comparison of actual prices with the Austrian National Bank's Fundamental Price Indicator, which measures objective supply and demand side factors, shows a renewed under-valuation¹ of property recently. By contrast, the comparison for Vienna, where prices have risen more sharply in recent years, shows an increasing degree of over-valuation.

6.4 Labour market barely improving

Employment grew further in January. The number of persons in dependent active employment (seasonally adjusted) rose by 0.1 percent (+2,900 persons) month-on-month in January. The number of job vacancies registered with the Public Employment Service has recently continued to decline, albeit at a slower pace than before. At the same time the number of unemployed persons has risen further: in January, 369,837 persons were registered as unemployed, an increase of 31,416 (9.3 percent) compared with January 2013. The number of persons enrolled in vocational training programmes also continues to rise, with the total number of jobless persons in January 2014 exceeding the year-earlier figure by 39,006.

According to the Austrian method of calculation, the seasonally adjusted unemployment rate stood at 7.9 percent in January, unchanged from the previous month.

¹ Schneider, M., "Are Recent Increases of Residential Property Prices in Vienna and Austria Justified by Fundamentals?", Monetary Policy and the Economy, 2013, (Q4/13).