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Robust Domestic Demand Supports the Economic Activity in Austria

Business Cycle Report of June 2019

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Following a slowdown in the global economic momentum over the previous year, world GDP expanded moderately in the first quarter of 2019. In line with this, domestic export growth weakened slightly. The domestic demand is supporting the Austrian economic activity. GDP in Austria rose by 0.4 percent in the first quarter of 2019 compared with the previous quarter.

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In the first quarter of 2019, the global economy is likely to have expanded only moderately, whereas development varied greatly from region to region. Real gross domestic product grew in the euro area and in the USA, while the economy continued to weaken in some emerging economies. Growth in domestic exports has recently been slightly subdued. In contrast, domestic demand again proved to be a stable pillar of growth for the Austrian economy in the first quarter. Private consumption expenditure growth continued to strengthen, and the high momentum of construction investments continued.

The leading indicators paint a mixed picture for Austria. According to the WIFO-Konjunkturtest (business cycle survey) in May, despite the slowdown since the economic peak at the end of 2017 and beginning of 2018, companies are still confident. In terms of consumer confidence, the positive and pessimistic assessments are balanced in the latest evaluation. The UniCredit Bank Austria Purchasing Managers' Index and uncertainty indicators, among others, reflect a noticeably more pessimistic outlook.

The economic slowdown is now beginning to have an impact on the labour market, although the situation is still favourable. According to preliminary estimates, the number of persons in active dependent employment continued to rise in May (+74,000 year-on-year). In terms of unemployment, on the other hand, the recovery is coming to an end, with the seasonally adjusted unemployment rate (according to the national definition) stagnating.

The inflation rate of 1.7 percent (CPI and HICP) in April 2019 was in line with the euro area average. Inflation in Austria remains moderate and even declined somewhat in

April compared to the previous month. The most important price drivers again were spending on housing, water and energy as well as on restaurants and hotels.

1. Global economy weakens

The global economy weakened in the course of 2018. In the first quarter of 2019, development varied highly from region to region. In the euro area and in the USA, real gross domestic product rose, with well-off special factors contributing significantly to both economic regions and thus hiding the actual course of the economy. In some emerging markets, the slowdown is continuing, particularly in Brazil and Argentina. In China, on the other hand, growth slowed only slightly compared with the previous quarter.

According to international surveys for the Purchasing Managers' Indices, production growth continued to slow at the beginning of 2019. The global service sector continued to outperform the manufacturing sector. The sub-indicator for incoming export orders remains at a comparatively low level. The continuing dampening of global trade can be partly explained by the turnaround in the global industrial cycle. A maturing economic cycle is generally accompanied by a lower investment momentum and a slowdown of world trade growth.

This pattern is currently very pronounced, as the manufacturing sector is causing the current weakness of the global economy. Manufacturing and global merchandise trade cycles are usually highly correlated.

The slowdown in the global economy is also reflected in an increase in uncertainty measures. Financial market-based measures of uncertainty, such as the VIX or VSTOXX index for implied share price volatility, have increased since the beginning of 2019. Other uncertainty factors paint a similar picture, such as the Baker Bloom Davis Index, which reflects global political uncertainty. This strengthens the prospect of a continuation of the sluggish dynamics of the global economy.

In the USA, expansion is continuing. Real GDP grew by 0.8 percent in the first quarter of 2019 compared with the previous quarter. The increase primarily reflected positive contributions from inventory investments. In line with a tense labour market, the average hourly wage level continued to rise rather strongly (April +3.2 percent year-on-year), thus continuing the upward trend that has persisted since 2015. While GDP growth continues to be supported by solid fundamental data, at least no further acceleration is to be expected in the coming months against the background of an overall less optimistic picture of leading indicators. In addition, the USA has had a negative yield curve since mid-May; in earlier economic cycles such a constellation was often followed by a recession.

Economic growth in the EU slowed further in the second half of 2018 as the expansion of the global economy and trade weakened. The reasons for this development were the tightening of financing conditions in some countries, above all the USA, unresolved trade tensions, high uncertainties and the exceptional weakness of the manufacturing sector, which lasted until early 2019. The slowdown was particularly pronounced in the euro area, as the region's largest economies are not only heavily dependent on foreign demand, but are also affected by a number of sector- and country-specific factors that weighed on trade. These include disruptions in car production, social tensions (France) and uncertainty related to Brexit.

Against this backdrop, the real GDP of the EU countries expanded surprisingly strongly in the first quarter of 2019 with +0.5 percent compared to the previous quarter. The major EU countries contributed significantly to this. In Italy, after a decline since mid-2018, overall economic production increased slightly again in the first quarter (+0.1 percent). In Spain, growth accelerated to +0.7 percent, the highest quarter-on-quarter increase in a year. In Germany, GDP grew by +0.4 percent in the first quarter compared with the previous quarter, significantly more strongly than the quarterly average of the previous year. In line with this, the unemployment rate in the EU countries as a whole recently continued to decline. Industrial production, on the other hand, stagnated.

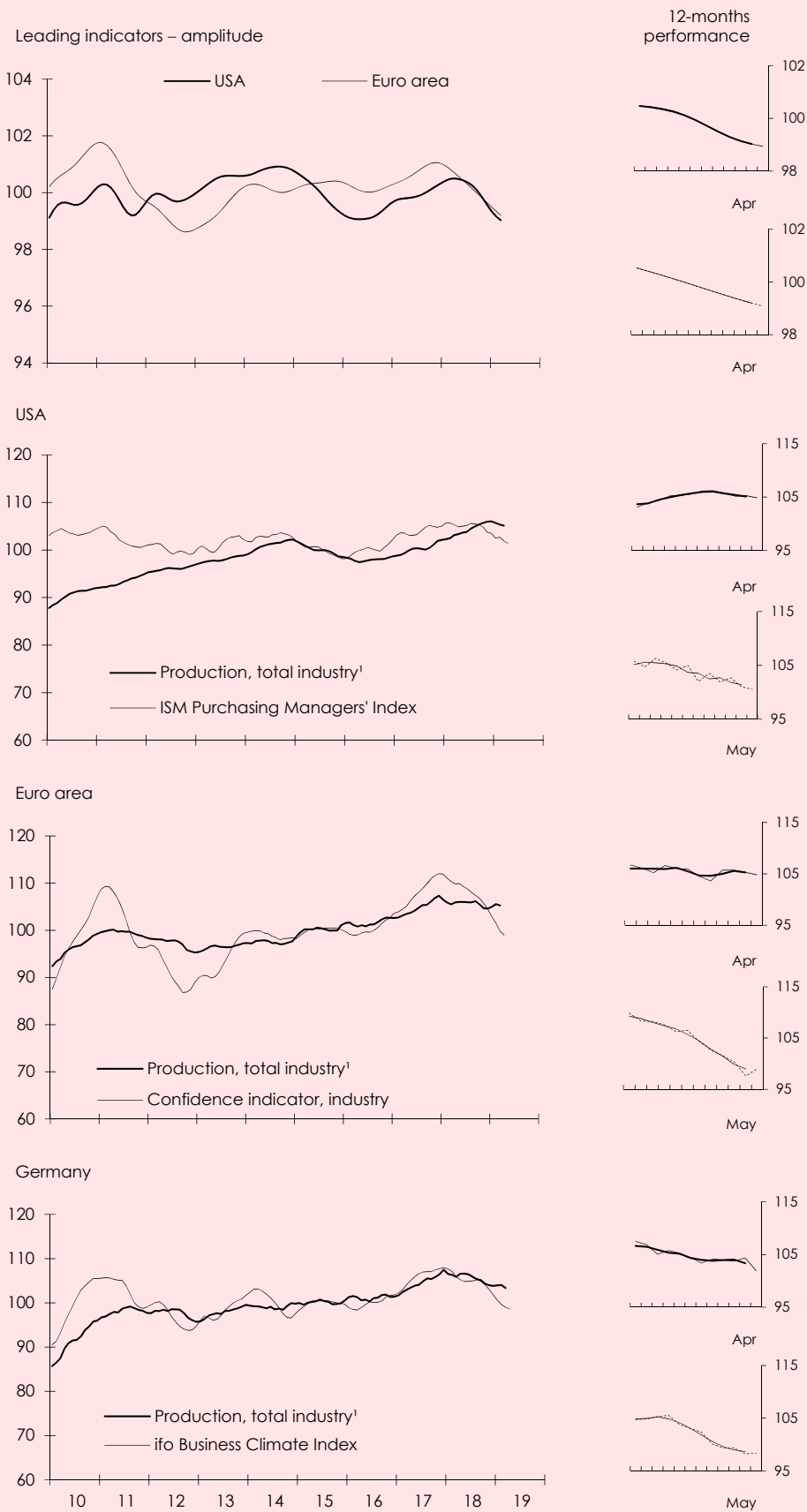
After a slowdown in growth over the previous year, the world economy expanded moderately in the first quarter of 2019, according to preliminary data.

In the USA, the economy grew unexpectedly strong in the first quarter of 2019.

In the EU countries, expansion was moderate in the first quarter of 2019 due to a combination of unfavourable global and domestic factors.

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.

Overall, the leading indicators point to a gloomy outlook. The Economic Sentiment Indicator of the European Commission continues to trend downwards; although it is still slightly above its long-term average, it points to a flattening of the economy. Similar signals are coming from the leading indicators for consumer confidence, industry and the construction sector.

2. Moderate but robust growth in Austria

The Austrian economy is growing moderately but robustly. At +0.4 percent compared to the previous period (trend-cycle component), the increase in GDP in the first quarter of 2019 was just as high as in the third and fourth quarters of 2018. Unadjusted GDP in the first quarter was 1.4 percent above the level of the previous year. The seasonally and working day adjusted GDP growth rate (indicator according to Eurostat standard) was also +0.4 percent (+0.1 percentage point compared to the WIFO Flash Estimate for the first quarter, trend cycle component also +0.1 percentage point compared to the WIFO Flash Estimate). Growth in Austria was thus as high as the average for the euro area (+0.4 percent) or somewhat lower than in the EU as a whole (+0.5 percent).

Domestic demand again proved to be a stable pillar of growth for the domestic economy in the first quarter. Both private consumption expenditure and public consumption expenditure expanded by 0.4 percent. Gross fixed capital formation (investments in machinery and equipment, weapon systems and in construction) grew robustly by 0.8 percent in the first quarter of 2019. Although the pace of investment in equipment slowed from the second half of 2018 onwards (first quarter of 2019 +0.6 percent, after an average +1.2 percent in the first half of 2018), investment in construction continued to expand strongly (first quarter of 2019 +0.8 percent, after an average +0.9 percent in the first half of 2018). Investments in vehicles declined.

Against the backdrop of moderate international development, Austrian exports grew by +0.6 percent, which was less than the average for the previous year. At +0.4 percent, exports of goods expanded more slowly than exports of services. Overall, this confirmed the picture of a slowdown in momentum since the fourth quarter of 2018. Demand for imports rose by 0.4 percent in the first quarter of 2019, imports of goods by 0.6 percent. The comparatively low import growth reflects the weakness of exports, as these have a high import content.

In industry, too, the economy recently lost further momentum. In the manufacturing sector, value added stagnated in the first quarter of 2019 (after +0.1 percent in the fourth quarter of 2018). However, the boom in the construction industry continued (+0.6 percent after +0.7 percent in the fourth quarter of 2018). The service sectors also supported economic growth. In the retail sector, value added increased by 0.1 percent, in the accommodation and food service activities by 1.2 percent. In the sector of professional, scientific, technical and administrative and support service activities value added increased by 0.5 percent.

2.1 Continued decline in leading indicators

The results of the WIFO-Konjunkturtest (business cycle survey) of May 2019 continue to show a rather confident assessment of the economic situation by Austrian companies, despite a significant decline compared to the previous year. However, there were significant differences between the sectors: while assessments in the manufacturing and construction sectors have recently improved, the mood in the service sectors has worsened. Although the index of assessments for the current economic situation for the economy as a whole in May was below the level of the previous month, it remained at a level that shows clear confidence. In the construction industry, the index remained almost unchanged, reflecting a very optimistic mood. In the service industries, the index fell, but continued to signal a good service economy due to its high level. In the manufacturing sector, which is important for the economy, the situation index strengthened again somewhat after the significant decline of the past few months and continues to record satisfactory economic assessments overall. The index of business expectations fell slightly, but reflected a moderately confident attitude. In

Strong impulses from domestic demand are shaping the course of the Austrian economy.

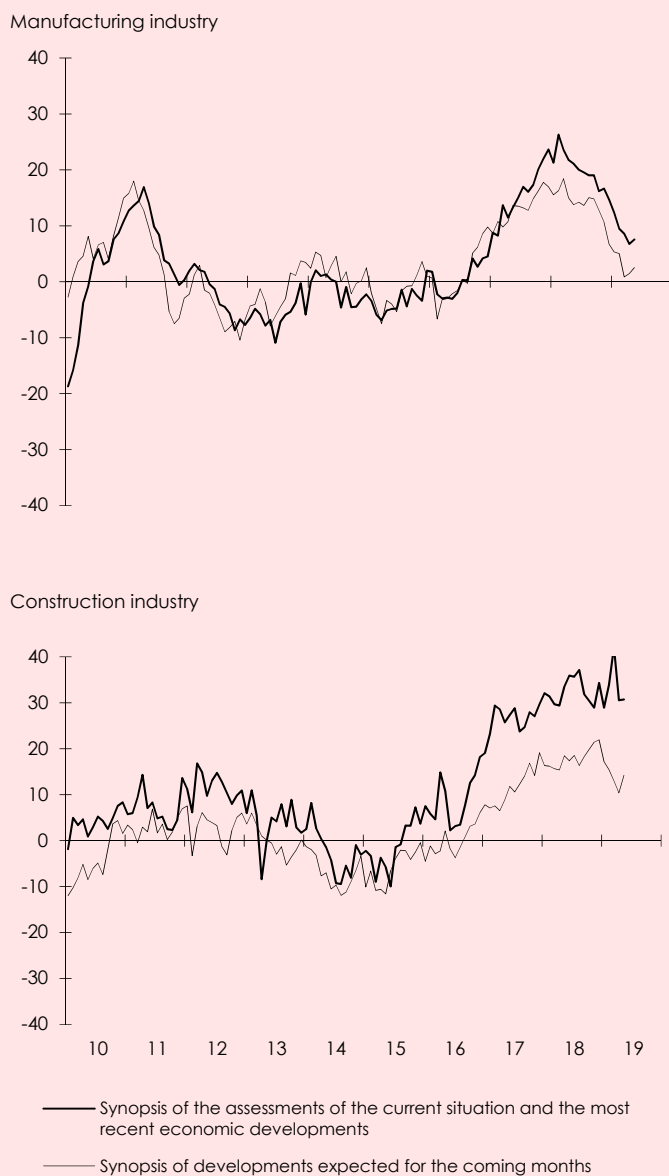
the construction industry, the expectation index rose and thus remained within the range of confident expectations; this index also rose in the manufacturing sector. In the services sector, on the other hand, it declined, although this sector remains optimistic.

The UniCredit Bank Austria Purchasing Managers' Index fell again in May and, at 48.3 points, was now again below the threshold of 50 points, which signals an expansion. After an upswing phase since April 2015, the indicator thus remained below the growth threshold for the second month in succession. The PMI for Austria was at a similar level to that for the euro area as a whole (47.7 points).

According to the European Commission's business and consumer surveys, consumer confidence in Austria improved significantly again in May after a sharp decline in April, with positive and pessimistic assessments balancing each other out.

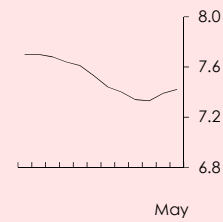
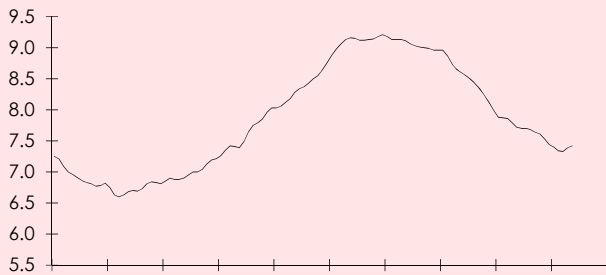
Figure 2: Results from the WIFO-Konjunkturtest

Indices of the assessment of the current economic situation and of business expectations, seasonally adjusted

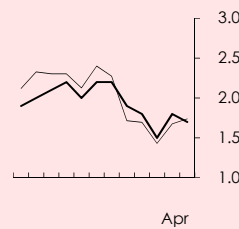
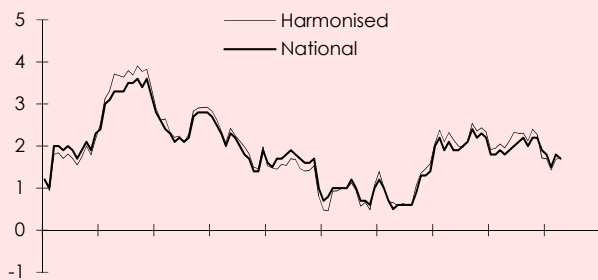


Source: WIFO-Konjunkturtest. Data refer to index points (percentage points) between +100 and -100. Values above 0 imply positive expectations, values below 0 indicate negative expectations.

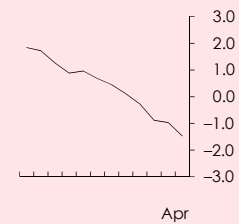
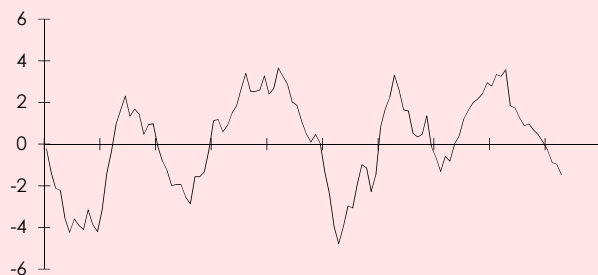
Figure 3: Key economic indicators

Persons in active dependent employment¹, 1,000s, seasonally adjustedUnemployment rate, traditional Austrian method², seasonally adjusted

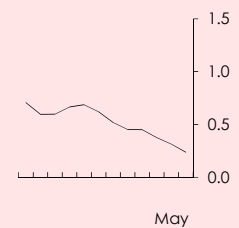
Consumer prices, year-to-year percentage changes



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.

2.2 Recovery in the labour market loses momentum

Economic growth continues to favour the development of the domestic labour market. According to preliminary estimates, the number of persons in active dependent employment in May was 74,000 higher than in the previous year (+2.0 percent). Seasonally adjusted, the increase compared with the previous month was 5,600 (0.2 percent). The expansion in employment thus continues. In April additional workers were hired especially in the manufacturing and construction sectors.

However, the number of seasonally adjusted vacancies is no longer increasing. The recovery, which has now lasted for more than three years, is gradually coming to an end, as the clear flattening of the ratio of unemployment to vacancies shows. The number of unemployed registered with the Public Employment Service Austria (AMS) in May was 7,200 lower than in the previous year (-2.5 percent), including persons in training it was 16,400 lower (-4.6 percent). Seasonally adjusted, the number of unemployed rose by 0.5 percent compared to the previous month. The seasonally adjusted unemployment rate (according to the national definition) thus remained at 7.4 percent in May. Compared to the previous year, the decrease was 0.3 percentage points.

2.3 Moderate rise in prices despite significant inflation in the housing and restaurant sectors

At +1.7 percent, the inflation rate in April 2019 was 0.1 percentage point lower than in the previous month. The main reason for the decline was the significant slowdown in the price of package holidays. Once again, spending on housing, water and energy as well as on restaurants and hotels proved to be the most important price drivers. Expenditure on housing, water and energy rose by an average of 3.0 percent year-on-year, thus contributing +0.58 percentage points to general inflation. In the Restaurants and Hotels sector, prices rose by an average of 2.8 percent, mainly due to higher prices for catering services. Accommodation services cost 3.5 percent more than in the previous year.

According to the harmonised index of consumer prices, inflation in April was 1.7 percent. This was in line with the euro area average (1.7 percent) and slightly below that of the EU as a whole (1.9 percent). Inflation was comparatively high in the Netherlands (3.0 percent), the Baltic countries (3.1 percent on average), Bulgaria (3.1 percent), Hungary (3.9 percent) and Romania (4.4 percent). On the other hand, prices rose relatively moderately in Portugal (0.9 percent), Denmark (0.9 percent) and Croatia (0.8 percent).

Companies continued to expand employment in May. The decline in unemployment is slowing down.

Inflation has recently been moderate and even declined somewhat in April compared with the previous month. By contrast, prices in the housing, water, energy, restaurants and hotels sectors continued to rise strongly.