

Christian Glocker

Austrian Economy Still Weak at Present

Business Cycle Report of March 2015

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Economic output stagnated in the fourth quarter of 2014 compared with the previous quarter, according to WIFO Quarterly National Accounts. Compared with a year before, the decline was 0.2 percent. For 2014 as a whole, economic growth was 0.3 percent. The slight increase in the impetus provided by foreign trade towards the end of 2014 was too small to be able to offset the weakness in domestic demand. The picture painted by leading indicators, which has been bleak for quite some time now, darkened further. Against this background, economic momentum is likely to remain lacklustre also in the first quarter of 2015, notwithstanding the low levels of crude oil prices seen recently.

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While low crude oil price levels support the recovery of the global economy, activity continues to gather speed only gradually, with considerable divergence across regions. In the USA, growth remains robust, while momentum is moderating in China and is not strengthening in Brazil. The economic situation in Russia has deteriorated further; contagion effects on other emerging market economies have been limited so far. Global trade is showing signs of strengthening. Inflation is declining in many advanced economies on the back of falling energy prices. In the euro area, short-term money-market interest rates fell further in an environment of increased surplus liquidity, and temporarily even were at a new all-time low. Long-term interest rates also reached a new all-time low, reflecting sluggish growth and subdued inflation dynamics as well as expectations surrounding government-bond purchases by the Eurosystem. Meanwhile, stock prices in the euro area continued to rise. The nominal effective exchange rate of the euro and its bilateral exchange rate vis-à-vis the dollar weakened further.

The Austrian economy stagnated in the second half of 2014. It currently lacks expansionary impetus both domestically and from abroad. Weak domestic demand and exports and the decline in manufacturing and construction value added marked developments in the fourth quarter of 2014. Unsatisfactory order book levels, alongside falling domestic and foreign final demand and gloomy sentiment have made firms more cautious in their investment decisions. Hence the lacklustre trend seen in previous quarters continued at the end of 2014. Compared with a year before, aggregate production fell by 0.2 percent in the fourth quarter. Economic growth for 2014 as a whole was 0.3 percent.

Leading indicators, which indicate future economic developments, do not signal a pick-up in activity in the coming months either; on the contrary, many of them have even deteriorated lately.

Employment continues to rise, notwithstanding the subdued economic activity (persons in dependent active employment +22,000 in February 2015 compared with a year before; preliminary data), alongside briskly growing labour supply. In February, 397,600 persons were registered as unemployed with the Public Employment Service. Hence the seasonally adjusted unemployment rate was 8.8 percent.

1. Global economy stable in second half of 2014

The global economy is likely to have maintained the moderate pace of expansion seen in the third quarter also in the fourth quarter of 2014. Growth was broad-based across advanced economies in the fourth quarter of 2014. The US real gross domestic product, however, did not expand as sharply as during the previous quarter, when special factors (sharp increase in government consumption, i.a.) had boosted activity. Following the slowdown in the second and third quarters prompted by the value added tax hike, Japan's economy returned to an expansionary path. In the euro area, GDP grew at a somewhat brisker pace in the fourth quarter than previously, according to first estimates. In the large emerging market economies, the basic trends remained quite diverse towards the end of the year: while the expansion in China and India was still subdued – compared with previous rates – activity in Russia and Brazil is likely to have remained lacklustre.

1.1 USA: moderate growth in real value added

US real GDP increased by 0.5 percent quarter on quarter in seasonally adjusted terms in the fourth quarter of 2014 (third quarter +1.2 percent). Average growth was 2.4 percent. The very fast growth in the second and third quarters must be seen in the context of the contraction witnessed at the beginning of 2014. The expansion in the third quarter was also due to unusually brisk growth of government demand. The subsequent normalisation dampened overall economic growth in the autumn. This was counterbalanced by a positive effect of increased inventory stockpiling, though. Finally, private gross fixed capital formation grew at a somewhat slower pace. The sharp fall in oil prices did not yet have a noticeable retarding effect; investment in buildings and structures in the mining industry expanded at a similarly brisk pace as in the previous quarter. Private consumption growth, by contrast, accelerated further. A solid basis for this increase was the marked rise in real disposable income resulting from occasionally strong employment growth and lower energy prices. Pulled down by the sharp fall in crude oil prices, inflation in the USA dropped below 0 percent for the first time since the financial and economic crisis – in January, consumer prices were slightly lower than a year before. Purchasing power gains and a continuously improving job market suggest that private consumption will continue to grow quickly. On the other hand, a substantial cutback on investment in the mineral oil and gas industry may dampen economic growth noticeably.

The US economy is faring well, with indicators pointing to robust growth over the near term.

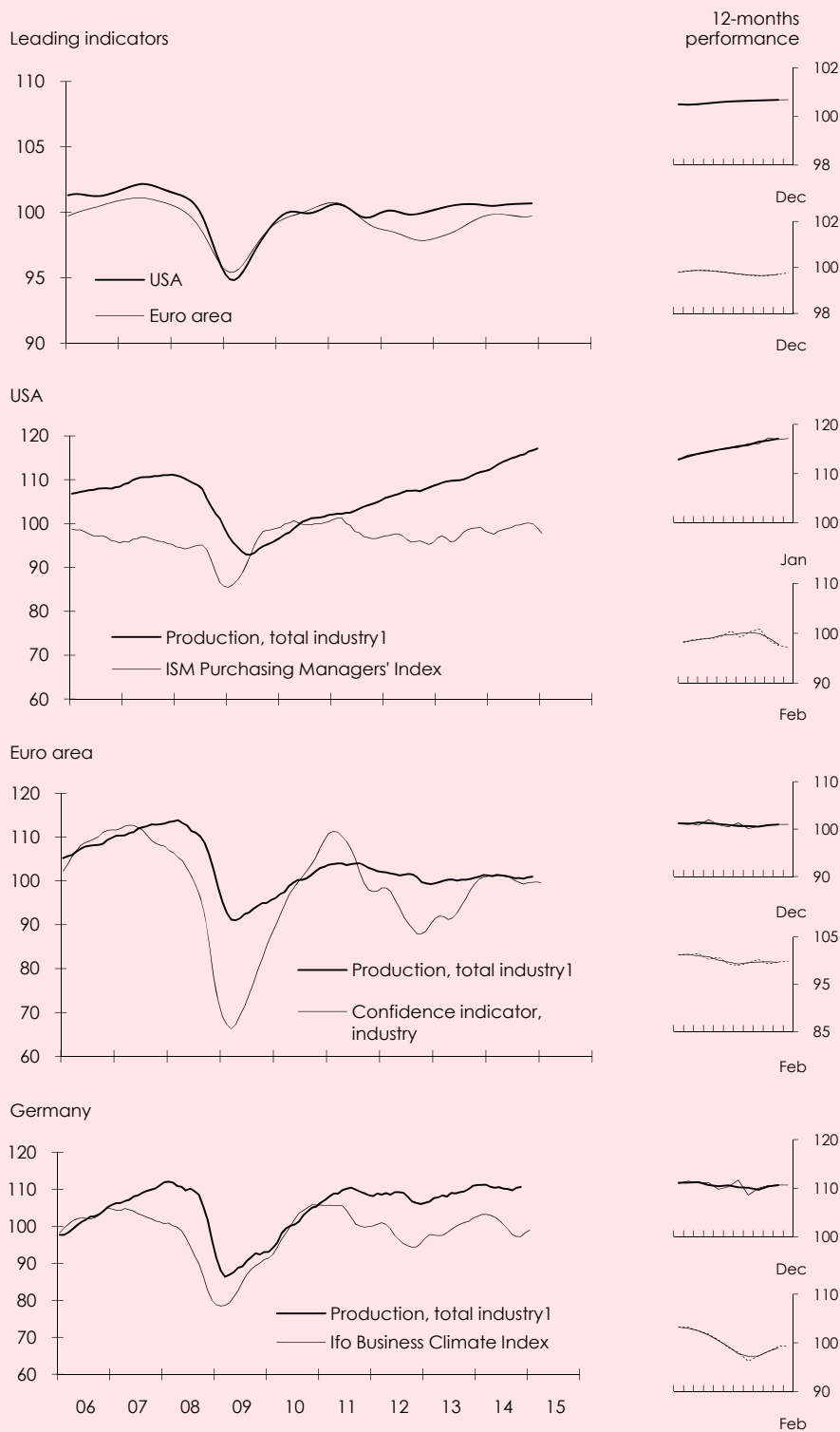
1.2 Favourable outlook for euro area as a whole

Economic activity in the euro area was somewhat more buoyant in the fourth quarter of 2014 than over the course of 2014. Seasonally adjusted real GDP increased by 0.3 percent compared with the previous quarter. The picture was diverse across euro area countries: among the largest economies, the strongest growth rates were recorded in Germany and Spain, while France recorded only a modest expansion. In Italy, real GDP stagnated following a continuous decline since the end of 2011. Greece again registered a marked decline for the first time in three quarters. According to survey-based indicators, economic activity may remain weak in Greece at the beginning of 2015.

Economic activity in the euro area shifted into higher gear in the fourth quarter of 2014.

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.

In the euro area, real GDP growth totalled just under 1 percent in 2014, following a contraction of 0.5 percent in 2013. It therefore still stood below the level recorded in 2008. According to the latest estimates by the European Commission, still more than 20 percent of the potential capacity is unutilised. At the country level, GDP growth remained highly diverse, with only three (Cyprus, Finland, Italy) of the 19 countries

recording a contraction, compared with ten and eight countries, respectively, in 2012 and 2013.

Industrial activity rebounded in the euro area in the autumn, following a slack summer half-year. In the fourth quarter, production expanded slightly over the previous quarter in seasonally adjusted terms. The annual average increase in 2014 was largely due to the vigorous start. The growth of industrial production in the fourth quarter was driven by the production of consumer goods; the production of capital goods increased slightly. By contrast, the production of intermediate goods stagnated, while the production of energy was curbed. Accordingly, capacity utilisation was somewhat higher in January than in October, thus moving somewhat closer to its long-run average.

An appreciable impetus to demand was provided primarily by private consumption in the fourth quarter of 2014. Real retail sales (excluding motor vehicles and fuels), for example, increased in seasonally adjusted terms compared with the third quarter. New passenger car registrations also rose. Investment demand may also have provided some impetus; equipment production and construction work performed also increased.

The labour market situation continued to improve somewhat at the beginning of 2015. The number of unemployed persons was considerably lower in January 2015 compared with a year before. This decline was primarily driven by favourable developments in Germany, Spain and a number of smaller EU countries, while unemployment continued to rise notably in Italy, but also in France. The seasonally adjusted euro area unemployment rate was 11.2 percent, 0.6 percentage point lower compared with January 2014. The modest upward trend of employment registered since the beginning of 2014 continued, particularly in the services sector. Strong employment growth was recorded in a number of peripheral countries.

The still unfavourable labour market situation continued to brighten somewhat.

The Markit Purchasing Managers' Index for the private sector, which summarizes survey data of service and manufacturing businesses, rose by 0.7 to 53.3 points in February, which was its highest level in seven months and clearly above the expansion/contraction threshold of 50. Hence the upswing in the euro area has gained traction, despite the ongoing debt crisis in Greece, and is likely to accelerate further in the coming months.

Leading indicators point to favourable developments in the spring.

The Economic Sentiment Indicator (ESI) published by the European Commission also confirms that the economic climate has brightened in the euro area and in the EU as a whole; it rose for the second time in succession in February. The increase was somewhat higher in the euro area than in the EU as a whole, given that the ESI stagnated in the largest EU countries outside the euro area (the UK and Poland). The positive development was mainly driven by the optimism shown by private households. The EU average increase in the consumer confidence indicator was in line with its increase in the euro area. Unlike in the euro area, however, confidence indicators fell EU-wide in the services and retail sectors, while they improved slightly in manufacturing and in construction.

2. Austria: no GDP growth in the fourth quarter of 2014

Austrian real GDP increased by 0.3 percent year on year in 2014 (after +0.2 percent in 2013), according to provisional estimates. Taking into account the number of working days, the increase was slightly higher (+0.4 percent). In contrast to the euro area average and to Germany, economic activity in Austria weakened in the latter half of the year: Following modest growth rates in the first half of the year, GDP stagnated in the third and fourth quarters.

The result in the fourth quarter of 2014 continued to be dampened by the weakness of domestic demand (stagnation compared with the third quarter of 2014, only +0.4 percent year on year) and firms' ongoing investment restraint (gross fixed capital formation -1.1 percent compared with the third quarter of 2014, -1.5 percent compared with the fourth quarter of 2013). The sharpest decline in the fourth quarter was observed in vehicle investment. Gross fixed capital formation has followed an

accelerating downward trend for almost a year (second quarter of 2014 –0.1 per cent, third quarter –1.0 per cent, fourth quarter of 2014 –1.1 per cent). The unfavourable international environment continued to weigh on goods production in Austria. Against this background, exports increased continuously, albeit only modestly, for instance by 0.2 per cent in both the third and the fourth quarter. In the first quarter they had still grown at a somewhat faster pace. Import demand declined noticeably in the second half of 2014, reflecting weak final domestic demand. Hence, net exports contributed positively to growth from a purely arithmetical point of view in the fourth quarter of 2014.

Cumulative exports from January to November 2014 to other EU countries remained below the year-earlier level, while extra-euro area exports increased. This development was only partly in line with economic trends in the respective countries. Exports to the important target countries Germany and Czech Republic, for instance, stagnated, despite the clearly stronger momentum there. The decline in exports to South America (notably Mercosur), Ukraine and Russia, on the other hand, was in line with the downturn in these target countries. Exports to North America rose very briskly, especially as a result of the sharp increase in exports to the USA.

The economic sectors on the production side of GDP followed different paths. Export-oriented industrial production declined in the fourth quarter against the backdrop of only modest foreign demand overall, and manufacturing value added decreased sharply compared with the previous quarter. Overall manufacturing output slowed to near-stagnation in 2014. The industrial production index fell in 2014 compared with a year before. The demand for labour in the manufacturing sector shrank accordingly. Employment was reduced on average for the year as a whole. Construction value added followed a similar pattern over the course of 2014: after growth in the first quarter, some substantial declines were witnessed over the remainder of the year. The services sectors showed a diverse picture: while public administration and other business services provided stable support to growth, value added decreased – in some cases very markedly – in trade as well as in the credit and insurance services and the information and communication sectors.

A noticeable shift in favour of employees became apparent on the income side. For instance, at +2.6 per cent, wages and salaries rose at only a slightly slower pace in 2014 compared with 2013 (+2.9 per cent). They picked up further at the end of 2014. Conversely, businesses recorded a decline in operating surplus in the fourth quarter of 2014; the total increase for 2014 as a whole was a mere 1.2 per cent (2013 +0.2 per cent). The wage ratio therefore increased slightly in 2014.

The general picture painted by leading indicators in Austria darkened considerably on a month-on-month basis in February. WIFO's Business Cycle Survey reflects businesses' ongoing scepticism: their assessment of the current situation and expectations for the coming months deteriorated compared with a month before. In February, the (seasonally adjusted) current situation index for the economy as a whole, for instance, fell far below its level in January; such a low reading had last been recorded in April 2013. This decline largely reflected developments in manufacturing. A similar deterioration in the index was registered in the services sector as well as in construction. Manufacturing also recorded the biggest decline in business expectations.

The growing scepticism witnessed in manufacturing is the result of a weakening production momentum and more unfavourable order book levels. The decline in business expectations largely reflects firms' more pessimistic assessments of the production activity and of business conditions in the coming months. Employment expectations also remain negative.

In the primary products sector, the current situation index dipped deep into negative territory, while the capital goods and consumer goods industries registered a modest deterioration. By contrast, the decline in the business expectations index was biggest in the capital goods industry and weaker in the consumer goods and primary products sectors.

Austrian GDP stagnated in the fourth quarter of 2014 compared with the previous quarter, according to WIFO's Quarterly National Accounts. Compared with a year before, it declined by 0.2 per cent. Economic growth for the year 2014 as a whole was 0.3 per cent. The slight increase in the impetus provided by foreign trade towards the end of 2014 was too small to be able to offset the weakness of domestic demand.

The picture painted by the leading indicators darkened in February compared with the previous month.

As the international comparison shows, the most unfavourable business climate developments in February compared with January were registered in Austria among all 28 EU countries. However, the business climate brightened somewhat on euro area average, and it also improved on EU average.

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.

The Bank Austria Purchasing Managers' Index also points to a persistent, albeit somewhat slower, downward trend in the Austrian industry. Though rising to 48.7 points in February, the index nevertheless continued to indicate slower growth compared with the previous month. The indicator has been below the expansion/contraction threshold for half a year now. According to the latest survey, jobs were cut and purchase quantities reduced, despite sharply falling energy prices. Firms also remain cautious with regard to stock-keeping. Apparently Austrian industrial enterprises continue to assess the business outlook with great reserve.

Private households are similarly pessimistic. Consumer confidence remains at a very low level.

2.1 Financing conditions remain favourable

The financing environment for the Austrian economy remains favourable. Secondary market yields on Austrian government bonds and on bonds issued by non-financial

enterprises were very low in February. Financing conditions in the credit market are also favourable.

After a modest easing of credit standards had been registered in the previous survey round on credit operations in the euro area, Austrian banks did not change their credit standards for business customers any further in the fourth quarter of 2014. This concerned loans to large-scale enterprises and the funding of small and medium-sized enterprises alike. However, a slight tightening of credit standards for loans to enterprises and unchanged standards for housing loans and consumer credits are expected for the first quarter of 2015. The margins for borrowers of average credit-worthiness as well as those on riskier loans were widened somewhat; in addition, loan maturity terms were applied more rigorously. The other credit terms (non-interest rate charges, additional or supplementary loan covenants, collateral requirements and size of loan) remained unchanged.

Another factor – apart from the supply side – dampening credit growth is weak demand: the loan demand from large-scale enterprises without exception dwindled somewhat in the latter half of 2014, while that from small and medium-sized enterprises remained unchanged. The decline was mainly due to diminishing financing needs for fixed investment.

2.2 Tourism Activity Remains Stable

At € 5,550 million (–0.8 percent), tourism revenue in the first three months of the current winter season dropped slightly below the level recorded in the same period in 2013-14, according to provisional calculations. Adjusted for price changes, total sales declined by 1.9 percent, while real expenditure per night spent fell by 2.5 percent – apparently guests continue to choose accommodation of lower – in terms of quality – standard.

From November 2014 to January 2015, the number of overnight stays rose by 0.6 percent overall to 29.0 million, the highest level since statistical records began. City tourism recorded higher-than-average growth rates (Vienna +5.9 percent) and therefore contributed substantially to growth, while the demand in the rest of Austria stagnated. Domestic demand picked up slightly (+0.8 percent); by contrast, the pace of growth in nights spent by foreign travellers – who accounted for more than three-fourths of the total demand – moderated somewhat overall (+0.5 percent), notably owing to the unfavourable result recorded in January 2015 (–0.8 percent).

In the first half of the 2014-15 winter season, only commercial and private holiday apartments recorded a substantial rise in the number of overnight stays (+3.2 percent overall); 5&4-star establishments (+1.2 percent) also registered above-average growth. In the other hotel categories, the number of nights spent fell moderately (2&1-star establishments –1.7 percent, 3-star establishments –1.0 percent), while nights spent in private accommodation declined more markedly (–6.8 percent). The number of overnight stays in the other accommodation categories rose slightly (+0.9 percent).

The demand from international guests for the destination Austria has varied greatly so far in the 2014-15 winter season: while a sharp increase was registered in the number of nights spent by guests from Poland (+18.9 percent), Italy (+11.2 percent), Romania (+9.6 percent), the USA (+8.0 percent), the Czech Republic (+6.8 percent) and the UK (+5.8 percent), and above-average growth was recorded in the source markets France (+4.0 percent), Switzerland and Sweden (+3.6 percent each), Belgium (+2.0 percent) and Denmark (+0.9 percent), overnight stays by guests from the Netherlands stagnated (+0.1 percent). Demand dropped (–1.1 percent) in Germany, the most important source market (November 2014 to January 2015: 40 percent of nights spent). A decline was also registered in the number of nights spent by guests from Hungary (–1.4 percent); demand from Russia plummeted by more than one-fourth (–26.3 percent).

In the first half of the 2014-15 winter season (November 2014 to January 2015), tourism revenue exceeded year-earlier levels only in Vienna (+3.0 percent) and Burgenland (+0.4 percent). Sales declined slightly in Tyrol, Carinthia and Lower Austria,

while the other Länder posted below-average results. A sharp fall was recorded in Vorarlberg.

2.3 Inflation easing markedly in January

Consistent with the economic slack and the fall in commodity prices (especially oil), inflationary pressures eased markedly in January. CPI inflation was +0.6 percent in January 2015 (December 2014 +1.0 percent), according to calculations by Statistics Austria. This was the lowest rate recorded since October 2009 (+0.2 percent). The decline was mainly driven by, inter alia, price declines for mineral oil products (fuels and lubricants and heating oil), which in January 2015 (–17.5 percent) were higher than those seen in December (–12.7 percent).

The largest upward pressure on annual inflation came from the "recreation and culture" expenditure category, owing, in particular, to price increases for package tours. In the "housing, water, energy" expenditure category, rent increases (+5.2 percent overall) were offset by price reductions for heating oil (–25.3 percent). The sharp fall in heating oil prices fed through to price developments of household energy overall. It was the second-largest driver of the downward drift in prices, the largest being the decline in fuel prices. The "food and non-alcoholic beverages" expenditure category had only a minor impact on inflation: in January, food prices were only 0.3 percent higher than a year before. In the "transport" expenditure category, the increase in the motor-related insurance tax in March 2014 – in addition to fuel price developments – continued to have an effect on inflation (+12.9 percent).

Inflation as measured by the Harmonised Index of Consumer Prices was +0.5 percent in January (December 2014 +0.8 percent). The deviation of –0.1 percentage point from the CPI is due to a different weighting of components: fuels have a higher weight in the HICP than they do in the CPI; consequently, the pass-through of their price decline was higher. Similarly, the increase in the motor-related insurance tax (not a weighting component in the HICP) and the increase in maintenance costs for apartments (smaller weight in the HICP than in the CPI) dampened the HICP compared with the CPI. Price increases in the "restaurants und hotels" expenditure group as well as for airline tickets (higher weight in the HICP than in the CPI in both cases), by contrast, resulted in a rise in the HICP compared with the CPI.

The inflation gap vis-à-vis the euro area average (+1.1 percentage points) and Germany (+1 percentage point), respectively, did not narrow further, despite abating price pressures. Three-fourths of this inflation differential are still attributable to substantially higher service sector inflation (+2.7 percent; Germany 1.2 percent, euro area 1.0 percent; in particular restaurants and cafeterias, package tours, mobile telephone services, rents, medical services). Food and energy contributed an additional 0.1 to 0.2 percentage point each to the inflation differential.

2.4 Labour market developments in Austria remain ambivalent

The heterogeneous development of production in the individual sectors is also reflected in the labour market. In 2014, headcount employment fell, for instance, in manufacturing (cyclical decline) and in the credit and insurance sector (sector-specific structural adjustment), inter alia. Employment in these two sectors declined further also at the beginning of 2015. Brisk employment growth was registered in 2014 in the information and communications sector as well as in areas close to the civil service sector (education and teaching, health and social services, as well as arts, entertainment and recreation). Overall, the number of persons in dependent active employment increased by 0.7 percent year on year in 2014, which was a slightly higher rate than the one recorded in 2013.

The number of job vacancies has been growing for two months on a seasonally adjusted basis. This strengthens the prospect of slightly more favourable labour market developments in the coming months.

In February, 397,600 persons were registered as unemployed (+1.3 percent in seasonally adjusted terms compared with January; +11.4 percent compared with a year before). 68,600 persons were enrolled in vocational training. Hence the number

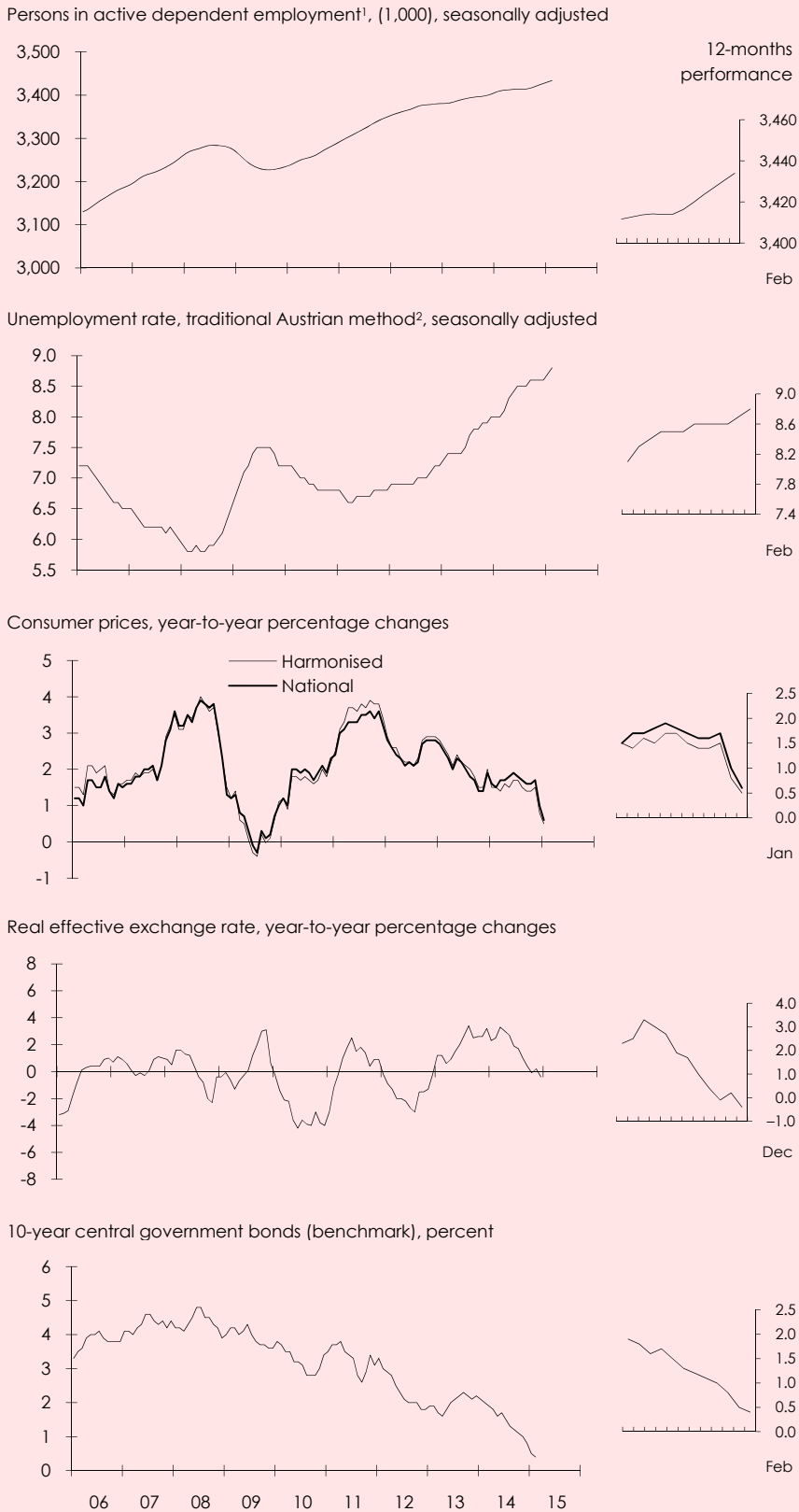
Excluding the price declines for mineral oil products, inflation would have been twice as high in January 2015.

Inflation as measured by the Harmonised Index of Consumer Prices was 0.5 percent in January 2015.

The labour supply continues to grow. Employment growth is accompanied by a marked increase in unemployment.

of persons without a job or enrolled in training totalled 466,200 in February. The seasonally adjusted unemployment rate was 8.8 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.