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Marginal Improvement in Global Economic Activity

Business Cycle Report of November 2016

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The Austrian economy expanded at a robust rate of 0.4 percent in the third quarter of 2016, in the context of the slightly improved picture painted by international indicators. Domestic demand remained the main driver of growth, while foreign trade once again had a dampening effect.

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The pace of global economic activity remains lacklustre, although international economic indicators point to a slight firming of the upward trend going forward. Commodity-exporting countries are beginning to benefit from the stabilisation of commodity prices at a higher level. Economic growth in the USA accelerated in the third quarter, supported by stronger foreign demand. The investment restraint exhibited by private companies continued, however.

In the EU as a whole and in the euro area, economic momentum remained unchanged. As expected, UK's vote to leave the EU was not reflected in euro area growth rates for the third quarter. Even the UK registered robust economic growth as well.

In the majority of the EU countries, private consumption was a key driver of growth in the first half of 2016. Evidence from consumer surveys suggests that this trend is likely to continue in the second half of the year. In Germany, retail sales increased during the third quarter, albeit with moderating momentum recently.

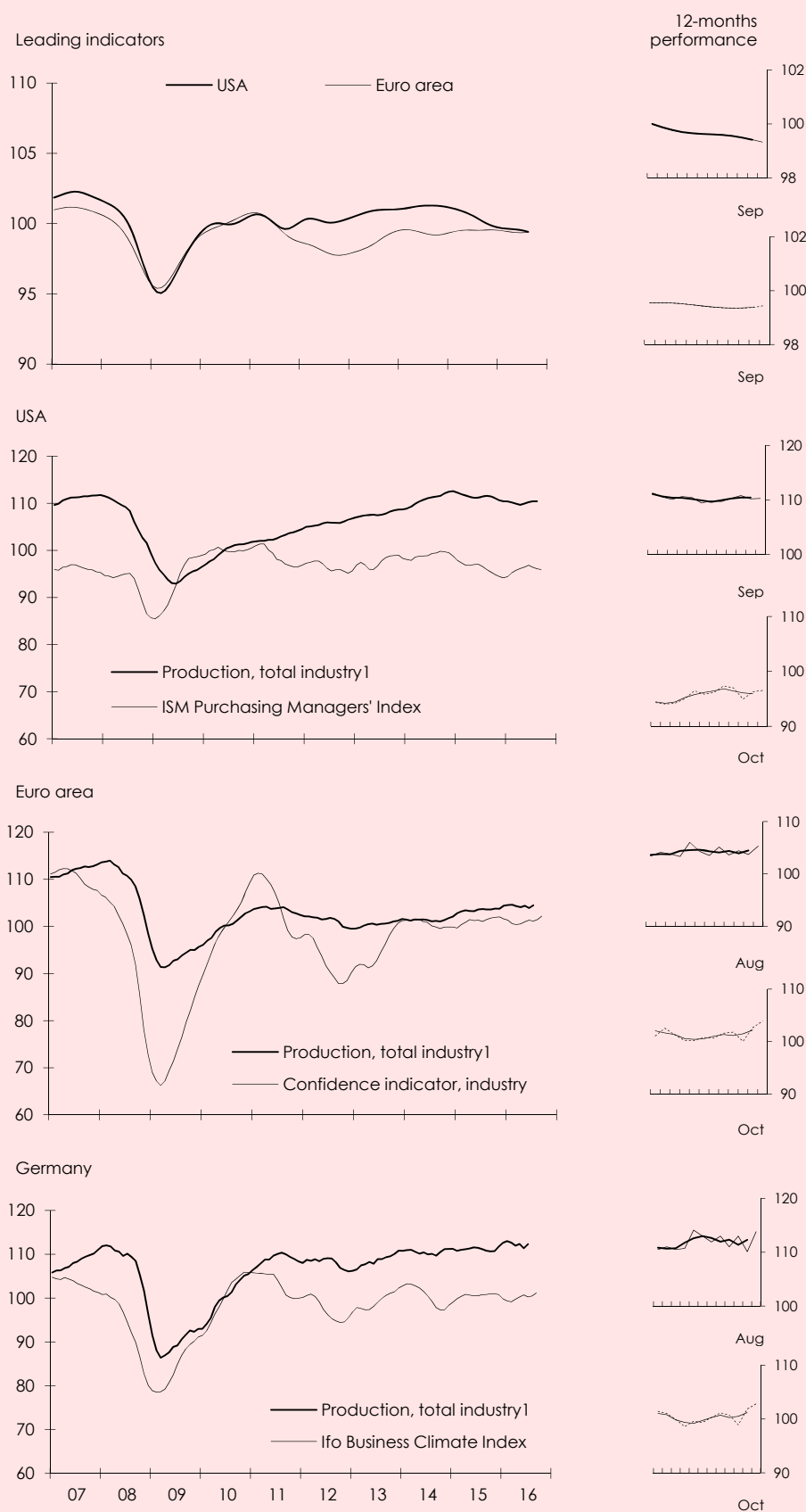
The Austrian economy expanded by 0.4 percent, quarter on quarter, in the third quarter, according to WIFO's Flash Estimate. Growth was once again driven by domestic demand. Owing to gains in their disposable income, private households have been more willing to purchase durable consumer goods (such as new cars).

By contrast, the contribution of net trade to GDP growth has been negative already since the fourth quarter of 2015, due to imports increasing more sharply than exports. Activity in the export industry has been correspondingly lacklustre. However, WIFO's Business Cycle Survey and the current development of the industrial production index point to an ongoing brightening of the climate in manufacturing.

Austria's tourism sector provided a positive stimulus. According to the data available so far, tourism revenue in the 2016 summer season (May until September) was the highest since 1995.

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.

Inflation (CPI) increased to 0.9 percent in September, notably on account of a markedly lower year-on-year decline in recent fuel price compared to previous months. The still strong inflationary pressures stemming from the "restaurants and hotels" expenditure category accounted for around one third of overall inflation.

No changes are apparent on the labour market: according to preliminary calculations, the number of persons in dependent active employment rose again on a seasonally adjusted basis in October compared with the previous month; compared with a year earlier, it increased by 1.6 percent. At the same time the seasonally adjusted number of persons unemployed stagnated compared with the previous month. In October, 340,800 persons were registered as unemployed. According to the Austrian method of calculation, the seasonally adjusted unemployment rate was 9.1 percent in October, almost unchanged from a month before.

1. World trade remains lacklustre

Against the background of the lacklustre performance of world trade, latest economic indicators show a slight upward trend. After the volume of world trade had shrunk in the first half of the year, according to CPB, faintly positive stimuli became again apparent in August. Asia's emerging market economies registered a small pick-up in trade.

As it was the case in the first and the second quarter, GDP growth in China increased by 6.7 percent in the third quarter; hence the development is in line with the government's target pace. It remains determined by a long-run decline in growth rates. The expansion in the first half of the year was sustained by domestic demand, while net trade barely contributed to growth.

In Latin America, there is increased evidence that the economy is recovering. The OECD's leading indicator for Brazil points to stabilisation. According to the CPB index of August, foreign trade activity in Latin America also increased. Commodity exporters in Latin America or also in Russia are gradually benefiting from the stabilisation of commodity prices.

The HWWI-Index of World Market Prices of Commodities (food, energy and industrial raw materials) has been recovering since March 2016. After the index (expressed in dollars) had stagnated for a short period of time in August and September, it picked up again in October and thus significantly surpassed its year-earlier level (+7.9 percent).

In emerging market economies, a growing amount of evidence points to a beginning recovery.

2. USA: growth accelerated in the third quarter

GDP growth in the USA increased by 0.7 percent, quarter on quarter, in the third quarter, according to the first flash estimate. Hence the expansion accelerated, compared with the weak first half of the year (first quarter +0.2 percent, second quarter +0.4 percent, quarter on quarter). Foreign demand, together with private consumption, sustained growth in the third quarter.

Hence the underlying momentum of economic activity remains subdued, held back by companies' investment restraint. Private fixed investment (equipment and buildings) contracted for the fourth consecutive time on a quarter-on-quarter basis.

The slack demand is also reflected in a sluggish industrial production growth. In addition, foreign trade factors, such as the strength of the dollar and the weakness of the global economy, have been acting as a drag for some time. However, recently there have been first signs of a mild recovery, with industrial production posting the first small quarter-on-quarter increase in a year in the third quarter. In October, the ISM Purchasing Managers' Index improved and slightly surpassed the expansion threshold; this bodes well for a rebound.

Private household demand expanded in the third quarter once again, albeit at a slightly slower pace than in the second quarter. Consumer confidence deteriorated somewhat in October, according to the Conference Board as well as Reuters and

Following weak economic momentum in the first half of 2016, exports sustained growth in the USA in the third quarter.

the University of Michigan. This may also be a consequence of the spike in inflation: the inflation rate increased from 1.1 percent in August to 1.5 percent in September, the highest level recorded since October 2014. This increase can be attributed primarily to energy prices. The monetary policy of the USA – maintaining the key interest rate at a level between 0.25 and 0.50 percent – remains expansionary. Judging by the rhetoric of the Federal Reserve, an increase before year-end appears likely, however.

3. Economic activity remains subdued in both the EU and euro area

The economic picture in the euro area and in the EU as a whole remains unchanged. According to Eurostat's flash estimate, GDP rose by 0.3 percent, quarter on quarter, in the euro area and by 0.4 percent in the EU during the third quarter. These growth rates are in line with those recorded in the second quarter. The economies of the large EU countries performed well: Spain's gross domestic product rose by 0.7 percent, while that of France increased by 0.2 percent.

The UK, where the majority of the population had voted against staying in the EU in June, recorded a GDP growth of 0.5 percent in the third quarter, which was once again largely driven by the services sector. Hence, the Brexit vote so far did not show negative effects on the British economy.

In the euro area and in the EU as a whole, private consumption supported growth in the first half of the year, whereas companies exercised investment restraint. The expansion of private consumption is likely to continue at present; this is suggested by the European Commission's latest Consumer Confidence Indicator. Further improvements in the labour market situation underpin the stable development: the number of unemployed persons fell further in September, compared with a year before, but the unemployment rate remained at 10 percent (euro area) and 8.5 percent (EU), respectively. Low inflation continues to strengthen private households' purchasing power; however, inflation has recently edged up. According to Eurostat's flash estimate, euro area inflation was 0.5 percent in October (September +0.4 percent, August +0.2 percent).

Against the background of the subdued expansion of the global economy, industrial production grew only modestly. Business surveys conducted by the European Commission in October point to a more dynamic expansion in the fourth quarter: capacity utilisation in the industrial sector improved, and the industrial confidence indicator rose markedly.

3.1 German companies more confident again

Economic activity in Germany is stable. GDP is assumed to have grown in the third quarter, too, following +0.3 percent in the second quarter. Retail sales increased by 0.8 percent year on year in the third quarter, with the growth momentum weakening somewhat recently, however. Consumer sentiment remains good, owing to noticeable increases in real wages and ongoing employment growth.

Industrial activity, by contrast, has been merely subdued since the beginning of this year. Leading indicators point to an improvement, however: according to the Ifo Business Climate Index, business confidence rose for the second consecutive time in October, and assessments of the current situation improved slightly.

4. Austria: consumption supporting the economy in the third quarter

According to WIFO's latest Flash Estimate, the Austrian economy expanded by 0.4 percent in the third quarter of 2016, compared with the previous quarter. The seasonally and working-day adjusted rate of change in GDP, which is comparable across the EU, was +0.5 percent. Hence the positive underlying momentum of economic activity in Austria strengthened further.

As expected, UK's vote to leave the EU was not reflected in the growth rates of euro countries in the third quarter.

Domestic demand has been the driver of economic activity in Austria since the beginning of 2015. Lacklustre global activity acts as a drag on foreign trade, however.

In the third quarter, growth was once again driven by domestic demand. Domestic companies stepped up their fixed investment; this increase in investment contributed 0.2 percentage points to the current growth of 0.4 percent.

Private consumption including consumption of non-profit institutions serving households also contributed 0.2 percentage points to growth. In 2016, gains in households' disposable income have increased their willingness to purchase consumer durables. The number of new car registrations by private persons has been rising briskly already since the end of 2015 (third quarter 2016 about +15 percent, compared with a year before). Consumer confidence has recently improved in Austria, according to the European Commission's Consumer Confidence Indicator.

The contribution of net trade to growth has been negative already since the fourth quarter of 2015. In an unfavourable international environment, cumulative exports of goods from January to July remained 0.3 percent below their nominal value a year earlier, amid falling export prices, according to foreign trade statistics. Imports of goods, by contrast, rose by 0.3 percent over the same period. Exports of goods to the EU 28 increased by 0.3 percent, while those to third countries declined markedly (-1.6 percent).

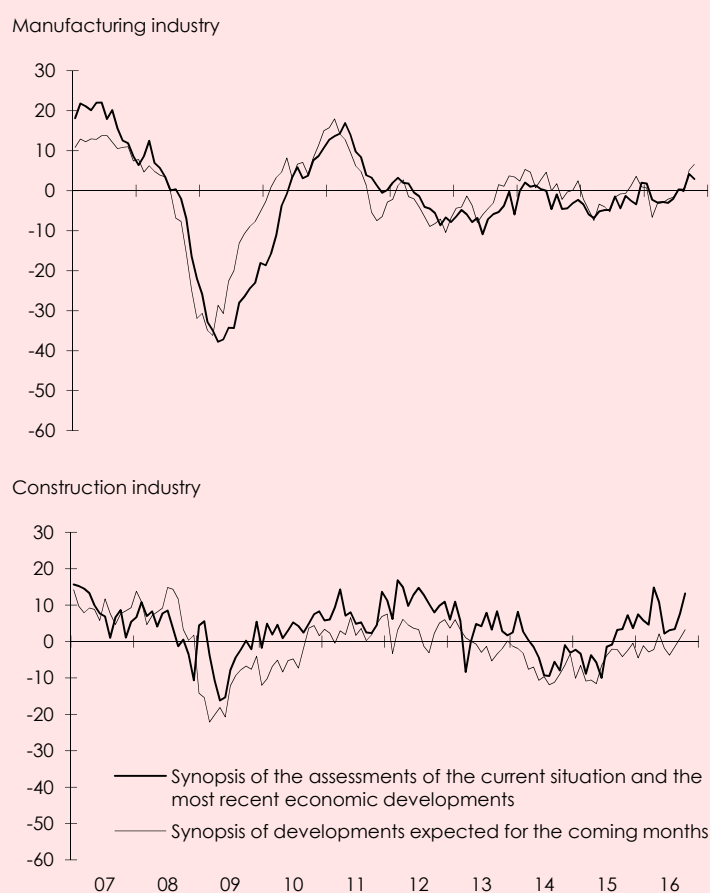
4.1 Pick-up in industrial activity

Against the background of weak export demand, industrial production in Austria was lacklustre, too, especially in the first half of 2016. Having declined on a month-on-month basis in May, June and July, the index of industrial production picked up again in August (+1.9 percent).

Leading indicators point to a pick-up in previously subdued manufacturing activity.

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.

Leading indicators point to a further improvement in the economic climate. In WIFO's Business Cycle Survey of October 2016, companies continued to be confident regarding the current economic situation and the outlook for the coming months. WIFO's Leading Indicator also rose further in October, compared with a month before. Continuing its upward movement; like in September, the rate of increase was exceptionally high. The indicator is currently at a level similar to that recorded in spring 2014. Its increase was driven by both domestic and foreign sub-indicators.

4.2 Tourism: high sales increases in summer season

According to the data available so far for the 2016 summer season (May to September), tourism revenue in Austria during this period was the highest since 1995 (nominal revenue +4.9 percent, real sales +4.2 percent, compared with the same period a year before), and the number of overnight stays increased by 4.4 percent. Especially the number of nights, resident tourists spent in Austria, increased (+5.4 percent).

The decline in the length of stay, observed since summer 2003, stabilised for the first time (-0.1 percent overall). Foreign travellers even stayed slightly longer (+0.2 percent) in Austria than they did last year. This may reflect the shifting of tourist flows, among other things: in the face of the political uncertainties in Turkey and in North African destinations (notably Tunisia), European guests preferred to spend their summer holidays in Europe.

4.3 Base effect drives up inflation in September

Inflation (as measured by the CPI) rose to 0.9 percent in September (0.6 percent in each of the months from May till August). This acceleration in the upward drift in prices was determined by the fuel price dynamics: the year-on-year pace of decline in fuel prices was markedly slower than in previous months.

Since the end of 2014, the "restaurants and hotels" expenditure category has been exerting strong upward pressure on prices and in September contributed +0.3 percentage point to inflation. Sharp price increases in this group continue to largely determine the inflation differential between Austria and the euro area average. In September, the EU-wide harmonised rate of inflation was 1.1 percent in Austria, once again higher than the euro area average of 0.4 percent.

Real estate prices in Austria rose again more sharply in the first half of 2016 (OeNB and Vienna University of Technology house price index for all of Austria: first six months of the year +8.8 percent compared with a year before, 2015 +4.1 percent). Except for Vienna, prices have recently been rising vigorously. In Vienna, the partly two-digit price increases registered previously had stabilised since spring 2014. The OeNB's fundamentals indicator for residential property prices, which measures objective supply and demand-related factors that have an influence on price formation, once again points to an overvaluation compared with the actual prices¹.

4.4 No changes on labour market

Employment in Austria continued to grow at approximately the same pace in October as in previous months, according to preliminary calculations (+1.6 percent, compared with a year before). Growth remained stable also on a seasonally adjusted basis (+0.1 percent, compared with the previous month).

At the same time, the number of unemployed persons remained almost flat compared with both a year and a month before. In October, around 340,800 people were registered as unemployed. Including unemployed people in training offered by AMS (Public Employment Service Austria), around 412,000 people were without a job.

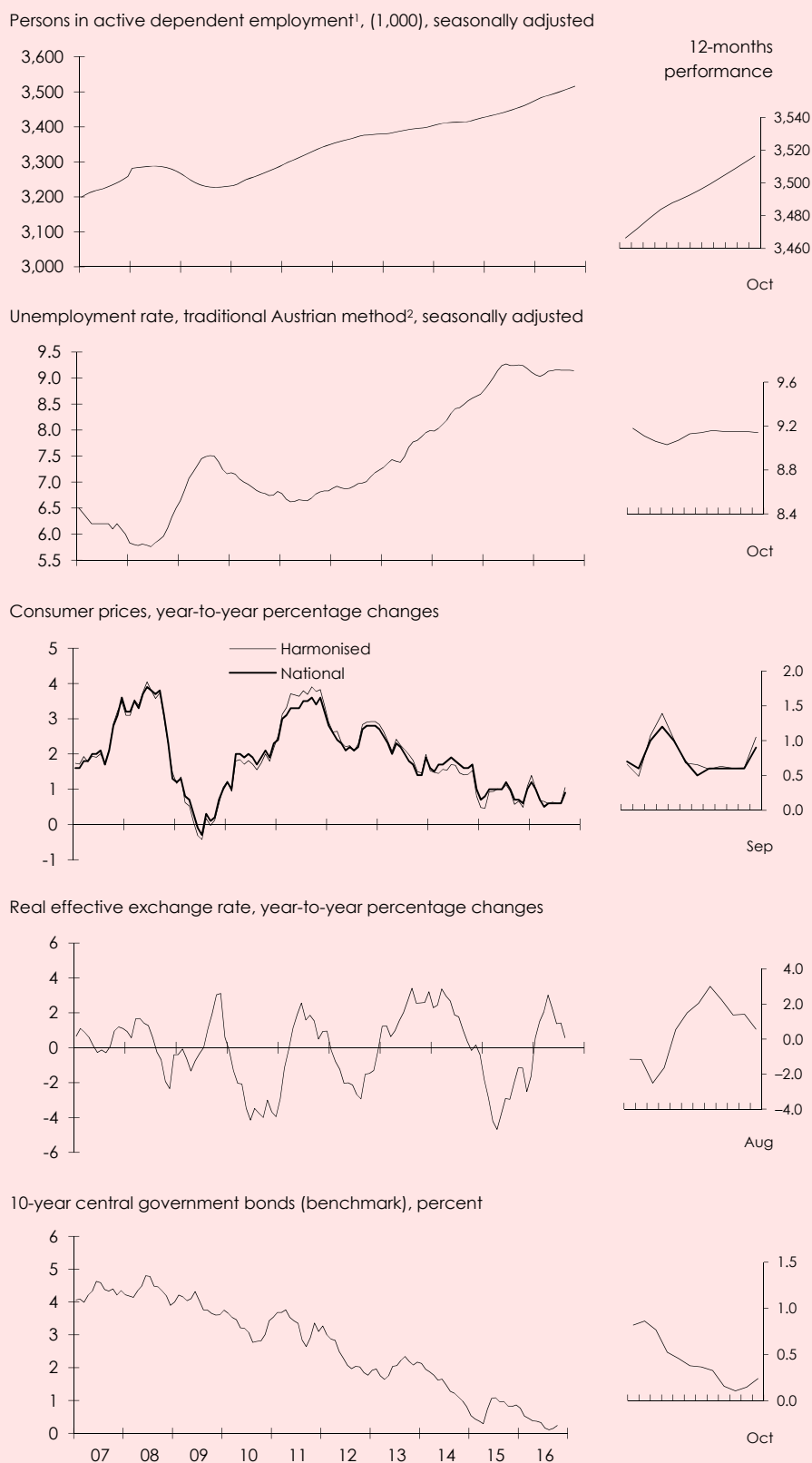
The good result from May to September 2016 supported tourism revenue in the summer season. Austria's tourism sector is benefiting from a redirection of tourist flows on account of geopolitical uncertainties.

Inflation accelerated in September. Fuel prices declined at a slower pace compared with a year before than in previous months.

¹ Schneider, M., Wagner, K., Waschiczek, W., OeNB property market monitor of October 2016: Acceleration of property prices in the first half of 2016 in Austria excluding Vienna and stabilize in Vienna, Vienna, 2016.

According to the Austrian method of calculation, the seasonally adjusted unemployment rate was 9.1 percent in October, slightly lower than in September (9.2 per cent).

Figure 3: Key economic indicators



Source: Public Employment Service Austria, Federation of Austrian Social Security Institutions, Oesterreichische Nationalbank, Statistics Austria, WIFO calculations. – ¹ Excluding persons with 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.