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Global Economic Activity Losing Momentum

Business Cycle Report of February 2016

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Economic indicators from abroad point to a slowdown in economic activity. WIFO's Business Cycle Survey likewise shows slightly growing scepticism among Austrian firms. However, for the time being the services sector appears to be affected to a greater extent than the cyclically sensitive manufacturing sector. Notably tourism companies complained in January that business was bad due to adverse weather conditions.

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The Austrian economy grew at a relatively steady pace until the end of 2015, according to first calculations. Growth accelerated from 0.2 percent in real terms quarter on quarter in the first quarter to 0.3 percent in the fourth quarter. For 2015 as a whole, real GDP expanded by 0.9 percent. Hence growth came in at less than 1 percent for the fourth consecutive year. Factors weighing on growth in 2015 were lacklustre private consumption and weak gross fixed capital formation. Both aggregates expanded at a year-on-year rate of merely 0.3 percent in real terms. Exports contributed to economic growth also in 2015, rising by 1.8 percent compared with a year before.

As WIFO's latest Business Cycle Survey shows, the Austrian economy is likely to have continued its modest expansion also at the turn of the year. The Present Situation Index, while falling somewhat (-0.5 points), nevertheless remained in slightly positive territory. Assessments given by businesses in the service sector, notably tourism and transport companies, were less favourable, while appraisals by firms in manufacturing remained positive.

The Expectations Index deteriorated for the second consecutive time, however, possibly in response to mounting signs of a global economic slowdown. Economic growth in the USA weakened considerably in the fourth quarter; the Purchasing Managers' Index points to slowing industrial activity. The most recent plunge in crude oil prices may also indicate in part a slackening of global demand and hence a cooling of global activity. The worsening of manufacturers' expectations of foreign orders in WIFO's Business Cycle Survey and the decline of the Ifo Business Climate Index for Germany are consistent with this development.

As already in previous years, weak private consumption weighed on overall economic development in Austria also in 2015. Although inflation was dampened by the collapse in energy prices, and incomes were about to improve as a result of the tax

reform, private households increased their consumption by merely 0.4 percent in real terms. Consumer confidence remained at an extremely low level also in January.

As the dampening effect on prices from declines in heating oil and fuel prices waned compared with a year before, the strong upward impact on inflation rent increases and higher prices of services related to the provision of food and drink had already had in the past carried greater weight. Therefore inflation in Austria rose again to 1 percent in December 2015, from 0.6 percent in November.

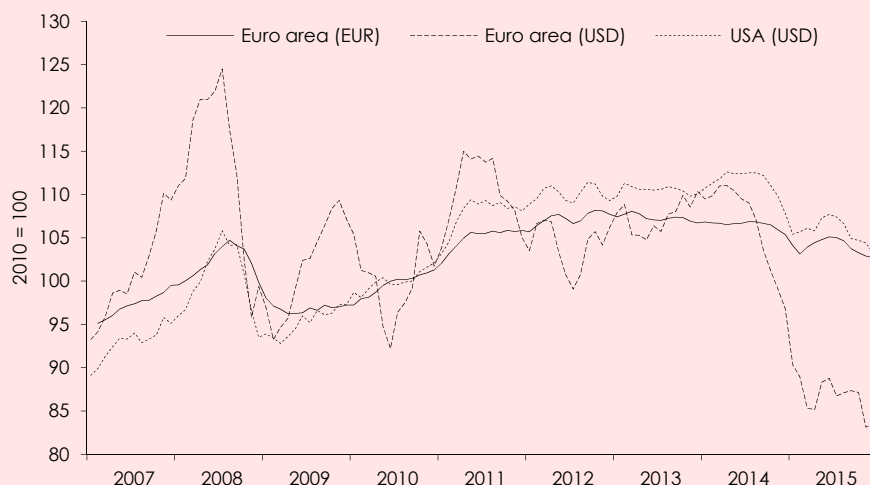
The situation in the Austrian labour market remains tense. In January 2016, the number of persons registered as unemployed or enrolled in training programmes rose by 17,700 from a year before, to 490,300; the increase was smaller than the one recorded in previous months, though. Excluding seasonal fluctuations, the number of jobless persons has been stagnating since November.

1. International business surveys show declining confidence

In the USA, economic activity has been gradually losing momentum in the past half-year. Following an expansion of 1 percent in the second quarter of 2015 and 0.5 percent in the third, the growth momentum flattened towards the end of the year, with real GDP growing by a mere 0.2 percent in the fourth quarter. While consumption, at +0.5 percent quarter-on-quarter grew only at a slightly slower pace, the decline in investment demand accelerated. Demand both for non-residential structures and for equipment fell markedly. Unfavourable exchange rate relations vis-à-vis many markets have been acting as a drag on the international demand for US products, and real exports dropped by 0.6 percent in the fourth quarter compared with the previous quarter. While since mid-2014 the decline in producer prices in manufacturing on the back of lower energy prices has been somewhat more marked in the USA than in the euro area when expressed in national currency, producer prices expressed in dollars dropped significantly in the euro area (Figure 1).

In the USA, industrial production has been stagnating since mid-2015.

Figure 1: Producer prices in manufacturing



Source: OECD, Eurostat, ECB, Macrobond, WIFO calculations.

Growth in the industrial sector came to a halt in the USA already in the autumn of 2015. The ISM Purchasing Managers' Index, which reflects industrial sector confidence about the business outlook, fell beyond the expansion threshold of 50 points in October and deteriorated further in November and December. It did pick up slightly in January, albeit remaining below 50 points. However, in the past this index was found to be very loosely related to the development of the overall economy. Consumer sentiment is much more decisive, given the high weight of consumption in aggregate demand. The respective surveys undertaken by the Conference Board

and the University of Michigan show that consumer confidence has stagnated at a high level since the beginning of 2015. The persistently favourable development seen in the labour market not only results in higher incomes of previously unemployed persons, but also increases the willingness to consume of all people in jobs, as the risk that they might lose their job is declining. The unemployment rate fell to 5 percent in December, from 5.7 percent at the beginning of 2015.

The inflation rate in the USA, having still been mostly negative in the first half of 2015, trended clearly upward over the remainder of the year. Following 0 percent in September and 0.2 percent in October, it rose to 0.5 percent in November and further to 0.7 percent in December. In December 2015, the central bank ended the zero interest rate policy it had pursued for seven years in a row and raised its key interest rate by 25 basis points. The euro has essentially maintained its value vis-à-vis the dollar since then, although the ECB discussed a further easing of its monetary policy. It appears that the markets expected a much faster and stronger tightening of the Fed's stance and are correcting this view now. The Japanese yen has even appreciated markedly vis-à-vis the dollar since the beginning of December, while the Chinese renminbi, by contrast, has depreciated by around 2.5 percent over the same period.

China's economy is currently going through a very turbulent and difficult patch. Trend growth has been gradually weakening for several years now. Following +7.3 percent in real terms in 2014, growth is assumed to have been less than 7 percent in 2015.

The international competitiveness of China's economy has already been declining for some time. The strong economic growth experienced over the past ten years was accompanied by brisk wage growth that led to increased consumption, however without offsetting the loss of export demand. In 2015, China's central government therefore allowed its currency to depreciate and cut the key interest rate several times. In the second half of 2015, the renminbi lost more than 5 percent of its value vis-à-vis the dollar. Another depreciation thrust set in November, which continued at the beginning of 2016.

*Growth slows further
in China.*

Table 1: Comparison of current forecasts for real GDP growth of selected economic regions

	2016	2017
	Percentage changes from previous year	
<i>USA</i>		
WIFO	+ 2.4	+ 2.6
European Commission	+ 2.7	+ 2.6
IMF	+ 2.6	+ 2.6
World Bank	+ 2.7	+ 2.4
<i>Euro area</i>		
WIFO	+ 1.5	+ 1.6
European Commission	+ 1.7	+ 1.9
IMF	+ 1.7	+ 1.7
World Bank	+ 1.7	+ 1.7
<i>China</i>		
WIFO	+ 6.2	+ 5.8
European Commission	+ 6.5	+ 6.2
IMF	+ 6.3	+ 6.0
World Bank	+ 6.7	+ 6.5

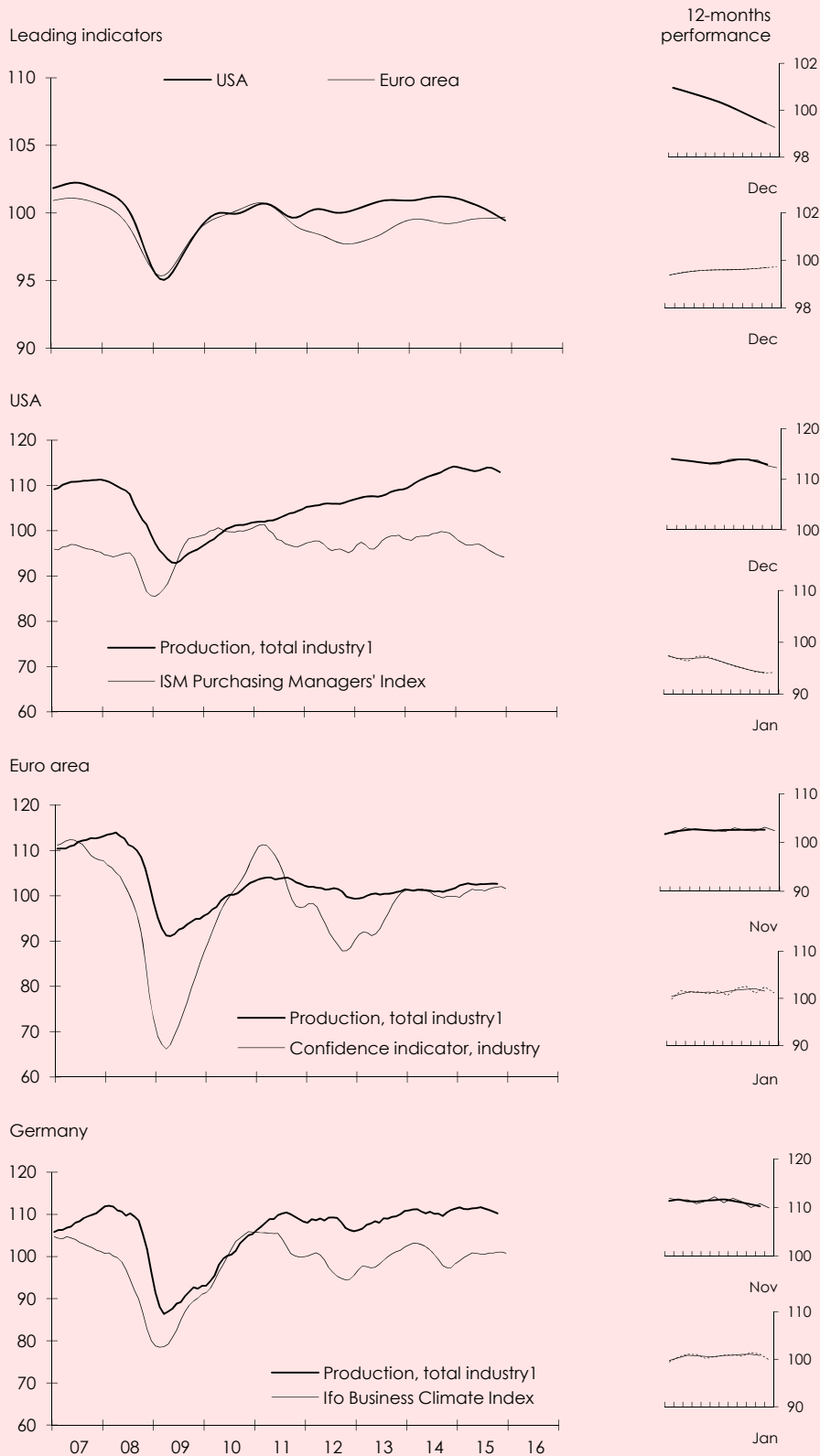
Source: WIFO (quarterly economic forecast of December 2015), European Commission (European Economic Forecast, February 2016), IMF (World Economic Outlook, Update January 2016), World Bank (Global Economic Prospects, January 2016).

The continuous loss of real economic dynamism and the high levels of indebtedness of regions, municipalities and companies raised doubts about the Chinese economy's expansionary strength going forward. On China's biggest securities market, prices collapsed by around 30 percent in mid-June 2015. The government reacted with support purchases and a temporary suspension of trading. Prices did stabilise, but fell again markedly in mid-August. They picked up again later in the year, but

plummeted again at the beginning of January 2016. Between June 2015 and the end of January 2016, the quotations of stocks constituting the Shanghai Stock Index halved and fell back to their levels recorded at the end of 2014.

Figure 2: 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.

Evidence that global economic activity is deteriorating has been mounting for several months now; therefore important international organisations such as the World Bank, the IMF and the European Commission have revised down their forecasts for some countries. The World Bank, for instance, anticipates growth of 2.7 percent for the USA, 6.7 percent for China, and 1.7 percent for the euro area (Table 1) in 2016. In spite of the revision, these forecasts still exceed the estimates made by WIFO in its forecast of December 2015. Against this background even an upward revision of the forecast for Austria would be justified at present.

2. Companies in euro area somewhat less optimistic

The worsening of the economic outlook for the USA and China also weighs on business confidence in Europe. The European Commission's Economic Sentiment Indicator fell in January, but this did not interrupt the slightly rising trend. The indicator's development in recent months still points to continuing economic growth in the first quarter. However, the assessment of new orders received does not suggest that a pick-up in momentum lies ahead. The Industrial Production Index for the euro area continued its languid upward trend until November; this was also consistent with developments in the EU as a whole.

The dampening effect on inflation from the decline in commodities prices is waning in the euro area given that the crude oil price in euro terms fell to a very low level already around the turn of the year 2014-15; hence the most recent price decline appears relatively weaker. Further price declines from the autumn of 2015 onwards were smaller. On several days in January, Brent crude oil prices reached around 28 \$ per barrel, their lowest level since 2003. Despite this renewed collapse in prices, inflation rose to +0.4 percent in January, according to Eurostat's first estimate (December 2015 +0.2 percent).

The inflation target of below, but close to, 2 percent cannot be reached, despite the massive monetary counter measures taken by the ECB. Consumer prices are broadly flat, owing to the sharp fall in commodities prices and continuing sluggish activity in the euro area. The low key interest rate has made loans cheaper for the private sector, but so far the latter has not yet increased investment and consumption. Both businesses and private households are undertaking continued deleveraging efforts. Uncharacteristically, the business sector in the euro area has even been running a financial surplus every year since the 2008-09 economic crisis. The "private households" and "government" sectors have also been increasing their surpluses or reducing their debt, respectively. Only if these financial surpluses are absorbed by foreign countries and used for imports from the countries concerned will it be possible to mitigate the negative effects of this situation, which is called Balance Sheet Recession, on aggregate demand. As these deleveraging efforts can currently be observed more or less in all euro area countries, an acceleration of the pace of economic growth can hardly be expected from this impact channel.

Historically low sovereign bond yields as a result of the ECB's government bond buying programme are relieving public budgets and thereby facilitating consolidation efforts. Besides, ongoing monetary easing by the ECB, accompanied by a tightening of monetary conditions by the US central bank resulted in the euro's depreciation vis-à-vis the dollar, which has provided additional stimulus to exports.

The unemployment rate in the euro area reacted with a lag to the strengthening of activity. From mid-2013 until mid-2014, the unemployment rate declined quite sluggishly from a level exceeding 12 percent. Since the autumn of 2014 it has been falling at a faster pace (December 2014: 11.4 percent, December 2015: 10.4 percent). The number of people in employment was up 1.1 percent in the third quarter compared with a year before.

Industrial production continues to grow at a sluggish pace in the euro area and the EU as a whole in the first quarter of 2016.

The dampening effect on inflation from the decline in crude oil prices is waning.

Unemployment in the euro area has been falling at an accelerating pace since mid-2015.

3. Growth in Austria unchanged in fourth quarter of 2015

According to first GDP estimates for the fourth quarter of 2015, the Austrian economy expanded by 0.3 percent quarter on quarter in real terms, the same rate as in the previous two quarters. This indicates a subdued but resilient upward movement and is in line with developments in the euro area. Nevertheless, growth for 2015 as a whole was only 0.9 percent. Hence the Austrian economy expanded by less than 1 percent for the fourth consecutive year. Having stagnated for two years, real personal consumption expenditure once again rose by a mere 0.4 percent. So far, the savings derived from the low energy prices, and the imminent improvement of incomes as a result of the tax reform from 2016 onwards have not stimulated households' willingness to spend. Consumer confidence even deteriorated until November, dropping to the lowest level since the 2008-09 economic crisis, and improved only insignificantly in December and January. The slight acceleration of consumption growth in the fourth quarter was due to increased expenditure on asylum seekers, and not a sign of a cyclical reaction of consumption.

Domestic production in 2015 was dampened by consumption and, once again, weak investment activity. Following a decline in 2013 and 2014, gross fixed capital formation rose by only 0.3 percent in real terms in 2015. A lack of demand for construction once again had an especially dampening effect, with construction investment declining by at least 1 percent for the third consecutive year. By contrast, equipment investment, at +2.8 percent in real terms rose again somewhat more briskly in 2015. But this increase is probably not sufficient to adequately raise the capital stock after the weak development in previous years; hence this investment may primarily be a replacement investment.

Given the economic slack in emerging market economies and the persistently difficult situation in the EU, exports (+1.8 percent in real terms) did not overcome the sluggishness observed in recent years (2012 +1.7 percent, 2013 +0.8 percent, 2014 +2.1 percent). The result at the beginning of the year was highly unfavourable, but momentum firmed thereafter. Imports rose by 1.6 percent in real terms in 2015, almost at the same pace as exports.

3.1 Business expectations deteriorated slightly also in Austria

WIFO's Business Cycle Survey of January 2016 shows a slight worsening of sentiment. Firms assessed both the present situation and the outlook for the coming months more unfavourably than a month before. This was not so much attributable to a global deterioration but to scepticism among Austrian service companies notably in the hotel and restaurant sector: in the first two months of the current winter season, tourism revenue in Austria was somewhat lower than in the same period a year earlier, according to preliminary calculations; real sales even fell by 1.6 percent. Two factors are likely to have significantly influenced this development: the mild weather and a snow-free November and December as well as the impediments to border traffic with Germany due to border checks in the course of the refugee movements.

In manufacturing, by contrast, the present situation index remained slightly positive, and the assessment of export order books even improved somewhat compared with the previous survey. Nevertheless, expectations for the coming months were slightly downgraded. But this downward movement is not yet inconsistent with the slightly rising trend seen in recent months. In WIFO's Business Cycle Survey of January 2016, firms exhibited greater scepticism with respect to new orders from abroad.

The industrial production index showed a slight upward trend until November, which business surveys suggest should continue at least throughout the first quarter of 2016. In January, WIFO'S Leading Indicator interrupted the upward trend observed in recent months and fell again for the first time.

The increased scepticism expressed in WIFO's January 2016 Business Cycle Survey was concentrated in the services sector.

Figure 3: Results from the WIFO Business Cycle Survey

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



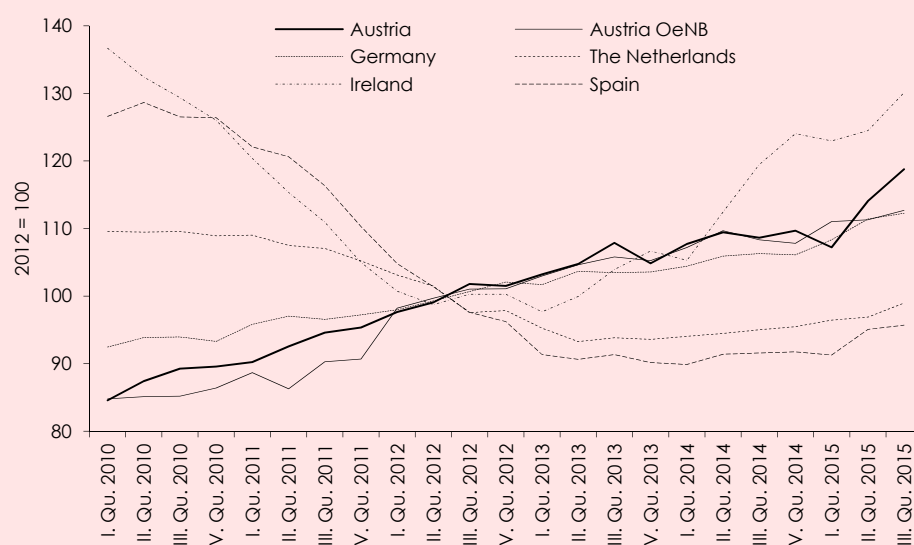
Source: WIFO Business Cycle Survey. Data refer to index points (percentage points) between +100 and -100. Values above 0 imply positive expectations, values below 0 indicate negative expectations.

3.2 Austrian construction industry so far shows no trend towards improvement

Construction output declined further in 2015, reflecting weak investment demand. However, firms' assessment of the present situation improved in the course of the year and approached its long-term average; hence the decline in construction production has likely come to a halt.

It is unclear why so far the extremely favourable environment notably for residential investment has not been able to stimulate demand more strongly. Financing costs, for instance, have reached record lows owing to the low interest rates, and the high demand has been driving up rents already for years. Real estate prices have also been rising continuously: according to the OeNB survey, the upward movement continued steadily in the second and third quarters; prices even soared over that period (Figure 4), according to the Statistics Austria indicator. In the third quarter, real estate prices in Austria rose by 9.3 percent, which was the second-highest increase registered in the EU as a whole, after Sweden (+13.7 percent). The demand for housing will rise considerably on account of the fast population growth, hence sales problems of the housing industry appear rather unlikely in the long run.

Figure 4: Development of house prices in selected countries



Source: Eurostat, OeNB.

3.3 Inflation accelerating again to 1 percent

For the first time in four months, consumer price inflation in Austria rose to 1 percent in December 2015, according to the national method of calculation. As in the euro area as a whole, the reason for this upward trend was the waning of the dampening impact of the decline in crude oil prices. The prices of mineral oil products did plummet further also at the end of 2015, albeit at a markedly slower pace than a year before (November 2015 –15.3 percent compared with a year before, December –12.1 percent, according to Statistics Austria).

As in recent years, the biggest price increases were recorded in the "restaurants and hotels" category (+3.3 percent), reflecting further price increases for services related to the provision of food and drink. Rents once again registered clearly above-trend growth (December 2015 +2.8 percent). Food prices, by contrast, at +0.5 percent compared with a year before increased barely at all.

The harmonised consumer price index rose by 1.1 percent in December 2015, after +0.5 percent in November. Hence Austria was again among the EU countries with the highest inflation rates. Only Belgium and Malta registered higher inflationary pressures (+1.4 percent and +1.2 percent, respectively).

3.4 Unemployment growing at slower pace

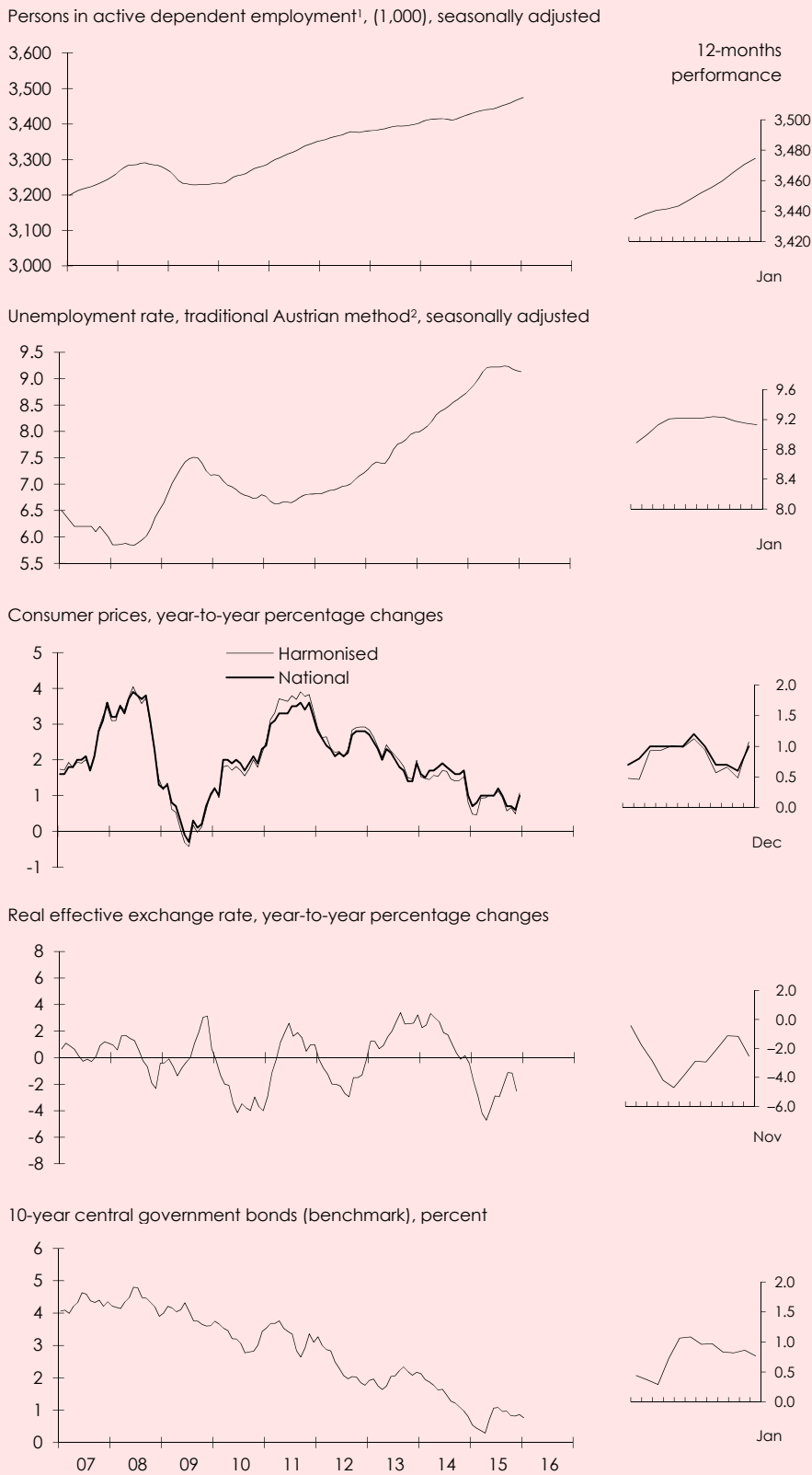
According to Public Employment Service Austria (AMS), 490,300 persons were registered as unemployed or enrolled in training programmes in January 2016, 17,700 or 3.8 percent more than a year before. Hence the increase slowed somewhat (December 2014 +19,600, +4.3 percent). Excluding seasonal components, a stagnation compared with the previous month could be observed already in December, which continued also in January. The picture is similar for the unemployment rate: it rose by 0.4 percentage point, month on month, in December, but only by 0.3 percentage point in January, to 10.9 percent according to the national definition. The seasonally adjusted unemployment rate stood at 9.2 percent between May and December 2015 and fell to 9.1 percent in January 2016.

Youth unemployment declined further, while in January much more older people and people from foreign countries were unemployed. Unemployment grew significantly in retailing (almost +3,000; bankruptcy of the supermarket chain Zielpunkt) and, owing to the unusually mild weather, in the tourism industry (+2,100).

The number of people in dependent active employment rose by around 1 percent, year on year, in January, which was similar to the average increase seen in previous months. Employment grew also on a seasonally adjusted basis compared with De-

ember. The number of job vacancies registered with Public Employment Service Austria rose further, although no longer as dynamically as in previous months.

Figure 5: 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.