

Stefan Schiman

Production Dent in the Automotive Industry Damps Growth, Especially in Germany

Business Cycle Report of December 2018

Production Dent in the Automotive Industry Hampers Growth, Especially in Germany. Business Cycle Report of December 2018

The backlog of exhaust emission tests led to a considerable build-up of inventories and production losses in the German automotive industry. Growth in industrial production also slowed down in Austria. However, this setback is not clearly linked to the automotive supply industry. The situation on the labour market continued to improve in November. The rise in energy prices should have peaked in October.

Contact:

Stefan Schiman, MSc: WIFO, 1030 Wien, Arsenal, Objekt 20, stefan.schiman@wifo.ac.at

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

All staff members of the Austrian Institute of Economic Research contribute to the Business Cycle Report. For definitions used see "Methodological Notes and Short Glossary", <https://www.wifo.ac.at/wwadocs/form/WIFO-BusinessCycleInformation-Glossary.pdf> • Cut-off date: 6 December 2018.

Data processing: Astrid Czaloun (astrid.czaloun@wifo.ac.at), Christine Kaufmann (christine.kaufmann@wifo.ac.at), Maria Riegler (maria.riegler@wifo.ac.at), Martha Steiner (martha.steiner@wifo.ac.at)

ISSN 1605-4709 • © Austrian Institute of Economic Research 2018

Impressum: Herausgeber: Christoph Badelt • 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

Since September 2018, passenger cars have had to undergo new exhaust emission tests for registration in the EU, which take more time. German manufacturers had apparently not prepared sufficiently for the changeover to certification, and in the summer, there was a backlog. In view of the considerable inventory build-up, passenger car production in Germany was cut back in the third quarter of 2018. Although many new cars were still sold in August, benefitting from high discounts, sales then slumped. Overall, private consumption declined. In Austria, too, the industrial economy cooled in the third quarter. Possible supplier effects are not clearly discernible, however, especially since goods exports continued to expand robustly overall. The dampening in private consumption in Austria was much milder than in Germany, although new car registrations reacted more strongly. Compared with the WIFO Flash Estimate, economic growth in Austria for the third quarter was revised downwards by 0.1 percentage point to 0.4 percent (+0.3 percent according to Eurostat calculation method).

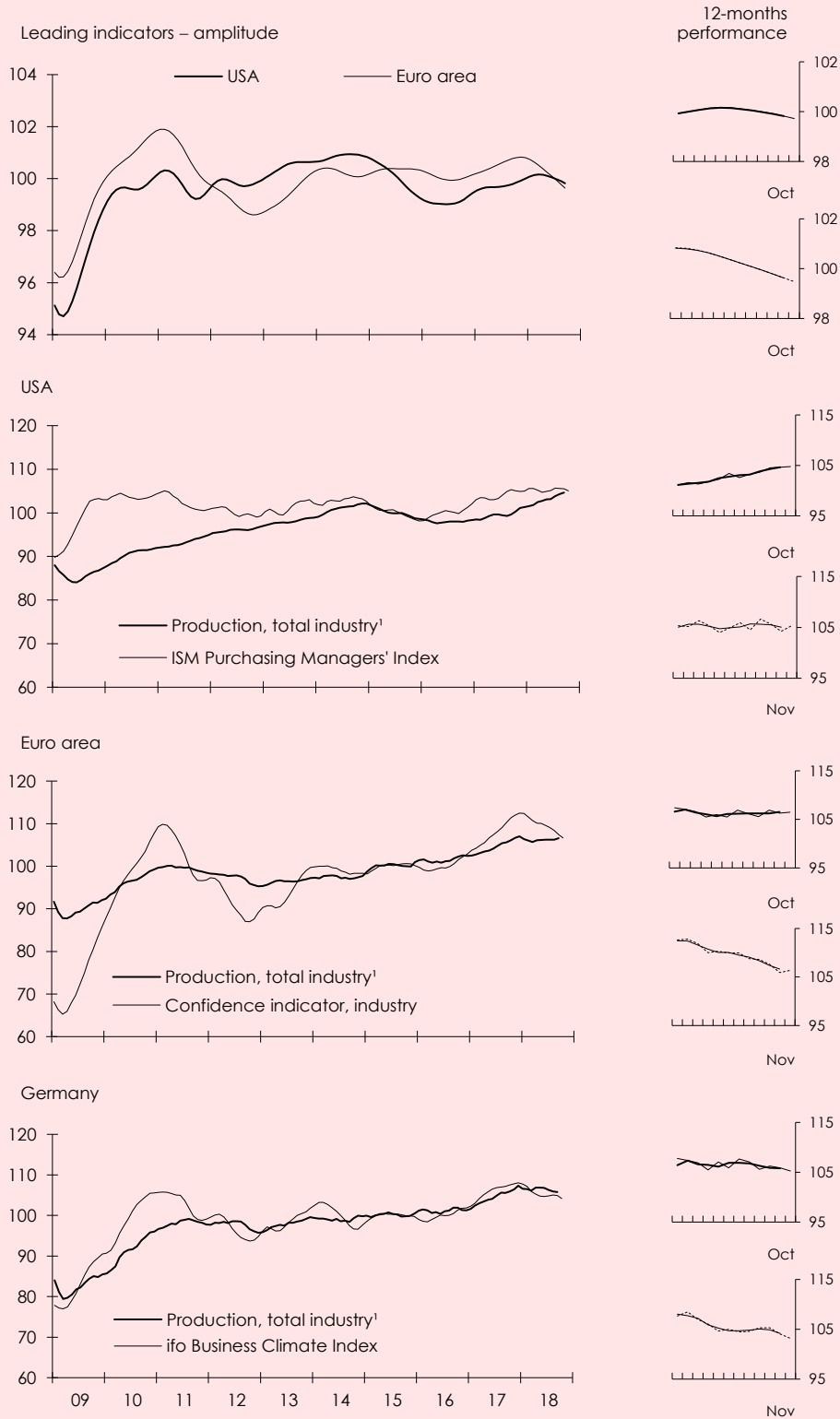
In the metal-working industry, the collective bargaining partners agreed on a salary increase that is close to the sum of overall economic productivity growth and consumer price inflation forecast for this year. However, wage negotiations proved difficult, not least because productivity growth in industry is accelerating faster this year than in the average for the economy as a whole. On the other hand, consumer price inflation is not determined by industry, but above all by the service sectors. Thus, both sides of industry achieved relative success in negotiations.

The price trend in Austria in October was again marked by rising energy costs, which contributed a good +0.7 percentage points to the inflation rate of 2.2 percent. However, the peak of the energy price increase is likely to have been reached: the price of crude oil, which had risen continuously since mid-2017, has been declining since

the beginning of October and recently fell below 60 \$ per barrel, partly because expectations of a drastic supply shortage in connection with the sanctions against Iran were not fulfilled.

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.

The situation on the labour market has recently improved further because of the economic situation. Overall, unemployment in November was somewhat higher than in October, but seasonally adjusted there was a decline; the unemployment rate stood at 7.6 percent. Both the supply of jobs and employment continued to expand.

1. First real economic effects of the trade dispute between the USA and China

About eight months ago, the US government announced that it would introduce or increase tariffs on a wide range of Chinese products, triggering a protectionist exchange of blows. The Chinese currency, the renminbi, has lost 3 percent of its nominal effective value since February 2018, and Chinese share prices plummeted by around 20 percent. The trade-weighted exchange rate of the dollar, on the other hand, rose by 8 percent, and share prices in the USA rose by 2.5 percent despite the sensitive losses in recent weeks.

The impact on trade flows has so far been limited and difficult to separate from possible other influencing factors, as the protectionist measures have only been implemented gradually. The last (and largest) round of tariff increases took place in September. China's exports grew strongly in October, even accelerating somewhat overall, but deliveries to the USA expanded at a below-average rate. On the one hand, Chinese exports were boosted by the devaluation, itself a consequence of the trade dispute. On the other hand, trade flows react with a time lag. For example, exports of product groups that had been subject to tariff increases at an early stage, such as solar modules, collapsed noticeably. Third, foreign trade is currently supported by pull-forward effects triggered by the announcement of tariff increases.

These three factors – devaluation, delayed impact and pull-forward effects – mean that Chinese foreign trade is still developing favourably. Survey results provide an indication of the impending development: the export component of the Chinese Purchasing Managers' Index for the manufacturing sector fell noticeably in October and announces a marked slowdown in export growth towards the end of the first quarter of 2019. This will not only affect manufacturers in China, but also their suppliers in other Southeast Asian countries. China's exports to the USA have a high import share, especially from Japan, Korea, Taiwan and Thailand.

The real economic effects of the trade dispute between the USA and China are still small. On the financial market, the development was unfavourable for China.

2. Passenger car supply bottleneck slows economic growth in Germany in the third quarter

In the third quarter of 2018, German GDP fell for the first time in three years compared with the previous quarter (–0.2 percent). For the time being, this reflects a temporary weakness due to high production losses in the automotive industry. The car manufacturers reacted too late to the new regulations for exhaust gas measurement for the certification of new cars, which came into force in September, and thus received registrations only after a delay. Thousands of cars were temporarily stored, including at Berlin's new, derelict airport. The increase in inventories made an unusually high contribution to growth of around +0.7 percentage points in the third quarter and stabilised the German economy. As a result of the associated warehousing costs, however, production was also cut back sharply (manufacturing industry –0.1 percent compared with the previous quarter, average for the second quarter of 2017 to the second quarter of 2018 +3.1 percent).

On the expenditure side, the negative effect of the decline in production in the automotive industry was reflected in private consumption (–0.3 percent compared with the previous quarter) and exports (–0.9 percent): planned car purchases had to be postponed, and new cars could not be exported to other EU countries without certification. Motor vehicle exports to third countries, on the other hand, did not collapse. Overall, according to an estimate by Oxford Economics, the development of the automotive industry slowed economic growth in Germany by 0.35 percentage points in the third quarter. However, this estimate only includes the direct effects, namely the failures in the "manufacture of motor vehicles, trailers and semi-trailers" (NACE 29). The effects on services, which are closely related to the car industry, are also likely to have

A backlog of new car exhaust gas measurements in Germany resulted in considerable stockpiling and a reduction in car production. Without the special effects in the automotive industry, the German economy would have grown in the third quarter.

been considerable: in the categories "wholesale and retail trade, transport, hotels and accommodation and food service activities" and "business services" the average growth in value added of +2.3 percent and +2.4 percent respectively came to a standstill (−0.5 percent each in the third quarter).

However, the basic economic momentum in Germany has not yet slowed significantly. Both gross fixed capital formation and imports expanded more strongly than on average in the previous four quarters (third quarter +0.8 percent and +1.3 percent, respectively). In addition, production losses in the automotive industry will be made up at least in part to cover the excess demand from the third quarter. How quickly this will be achieved depends above all on the capacities of car manufacturers and the progress made in certifying new cars in stock.

3. Industrial activity in Austria cools down somewhat in the third quarter

According to the current recalculation, the GDP growth rate in Austria in the third quarter was 0.1 percentage point lower than according to the WIFO Flash Estimate at the end of October. The economy is expected to have grown by 0.4 percent in the third quarter compared to the previous quarter (trend cycle component), according to Eurostat's calculation method by 0.3 percent. On the output side, growth in industrial production slowed to +0.2 percent. On the expenditure side, the slowdown in growth is reflected above all in higher destocking, while overall economic production expanded by a good 0.2 percentage points slower than demand in the third quarter. However, growth in private consumption also slowed somewhat (to +0.3 percent compared with the previous quarter). As in Germany, the special effects in the automotive industry probably played a role here.

3.1 Strong increase in exports to Italy, USA, China and Poland

Among the ten most important markets for Austrian exports, which account for more than two thirds of total goods exports, demand rose particularly strongly in Poland (+16 percent year-on-year), Italy, USA and China (+9 percent each) in the first nine months of 2018; total goods exports increased by 6 percent during this period. After exports to Poland, Hungary and the Czech Republic had expanded similarly strongly in 2017 (+10 percent each), the dynamics of deliveries to Hungary and the Czech Republic slowed somewhat this year. Lively demand from Poland could be a delayed effect, as exports declined in 2016, while exports to the Czech Republic and Hungary only stagnated.

According to an analysis at the disaggregated level, high demand from Italy and the USA was primarily driven by vehicle exports, which were still declining to Italy in 2017. Italy's sluggish general economic situation is not yet reflected in bilateral foreign trade. For the first time since the Brexit decision in 2016, exports to the UK are increasing again this year.

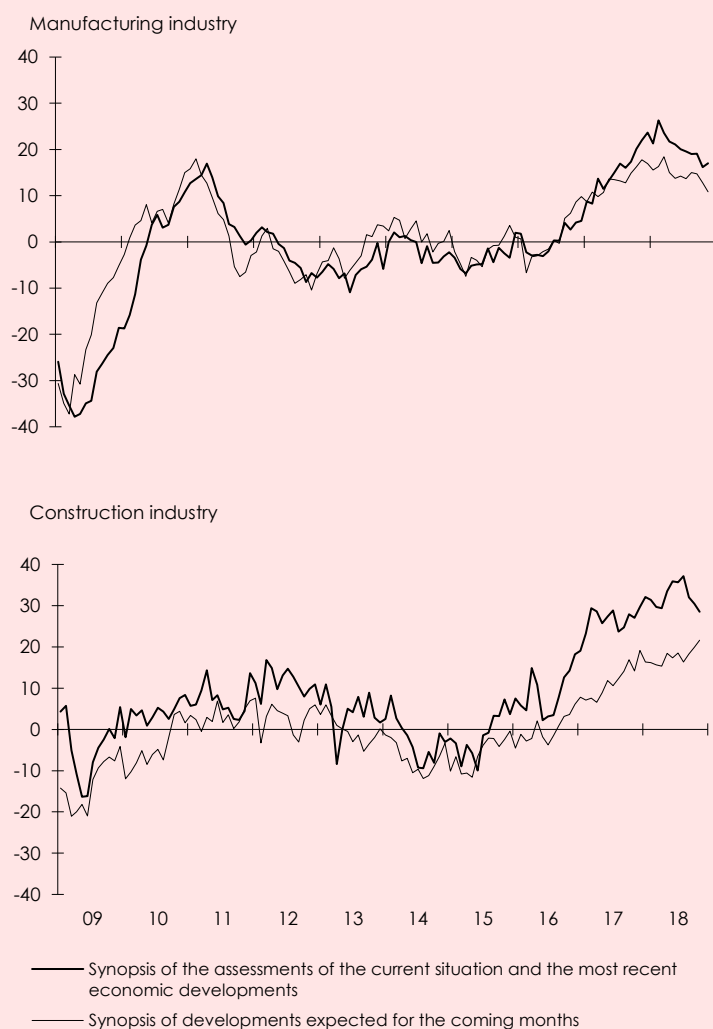
3.2 Productivity-oriented collective agreement in the metal-working industry

In November 2018, the collective bargaining partners of the metal-working industry agreed on an average increase in wages of 3.46 percent for the next twelve months. This agreement is close to the sum of the inflation rate (CPI +2.1 percent) and overall economic productivity growth per capita (real GDP per employed person +1.1 percent) forecast for the current year, adjusted for the trend decline in working hours per capita¹ (1995-2017 +0.5 percent per year). In line with the usual anti-cyclical development of labour income, wage settlements were above average between 2012 and 2014 and have since been below average.

¹ Alternatively, the sum of the inflation rate and the change in hourly productivity could be used. However, in some years the annual values of the number of hours worked show jumps that are not comprehensible from a macroeconomic point of view (e.g. 2015-16), so that only the long-term average seems halfway meaningful.

Figure 2: Results from the WIFO-Konjunkturtest

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



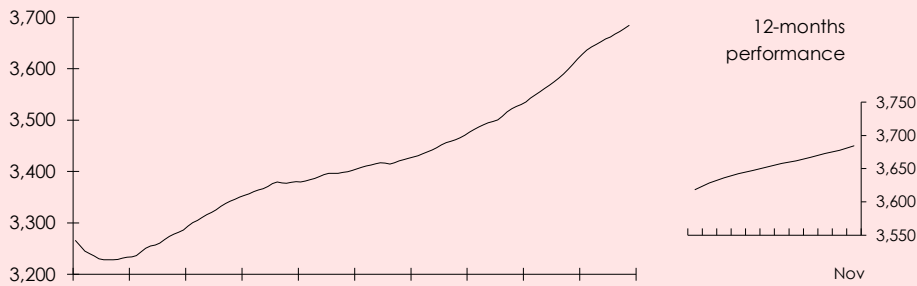
Source: WIFO-Konjunkturtest. Data refer to index points (percentage points) between +100 and -100. Values above 0 imply positive expectations, values below 0 indicate negative expectations.

Salary negotiations proved to be exceptionally difficult this year, with warning strikes being held. This was due, among other things, to above-average productivity growth and thus greater scope for distribution in industry (production per employee +3.8 per cent); the productivity gap between the production of goods and the service sector widened further. In the manufacturing sector, lively international demand led to a strong increase in productivity, as capacities are limited and international competition is intense. Although demand in construction and services also grew rapidly, productivity gains are only possible to a limited extent, so that prices rise much faster than in industry. Compensating for the macroeconomic price pressure in wage settlements is therefore more to the advantage of employees in the metal industry, because industry cannot adjust its prices as strongly. Compensating for productivity growth of the overall economy, on the other hand, is more to the advantage of companies, as productivity in industry rises more strongly than in other sectors. Thus, both bargaining parties achieved relative successes in negotiations and, at the same time, the purchasing power of employees and the competitiveness of the metal industry were preserved.

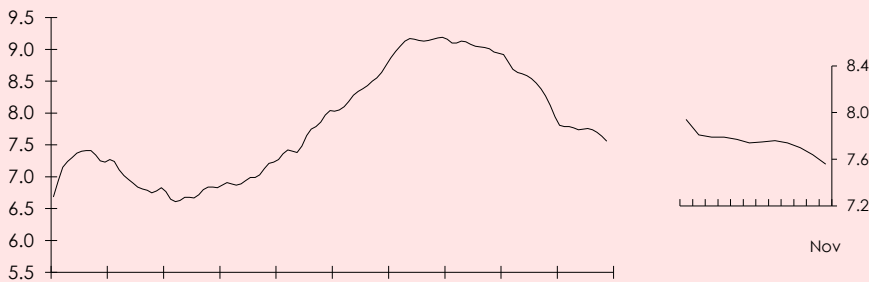
Both employers and the trade union achieved relative successes in wage negotiations for the metal-working industry.

Figure 3: Key economic indicators

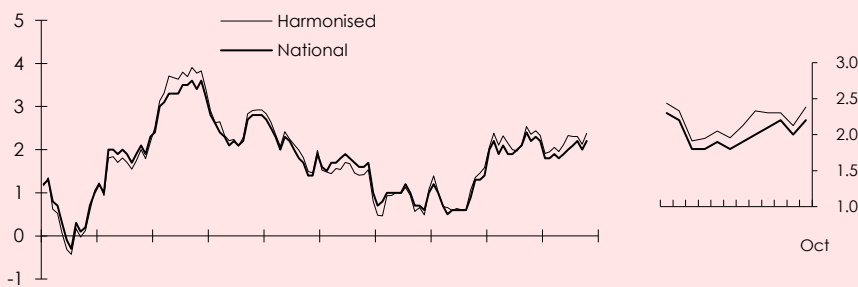
Persons in active dependent employment¹, 1,000s, seasonally adjusted



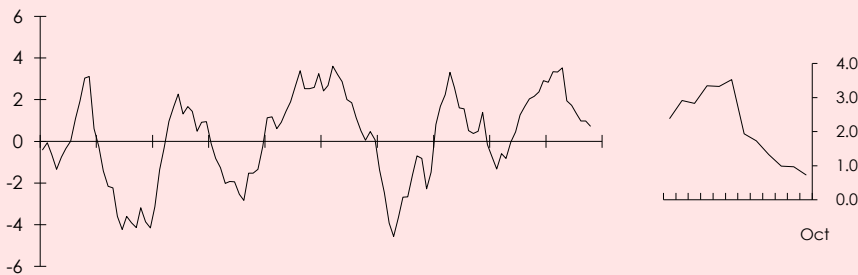
Unemployment rate, traditional Austrian method², seasonally adjusted



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.

3.3 Strong demand in summer tourism

In the 2018 summer season (May to October), according to initial estimates by WIFO, tourism in Austria recorded a nominal increase in turnover of 3.5 percent over the previous year. More than two thirds of the 76.7 million overnight stays (+2.3 percent) were accounted for by foreign guests, whose demand rose by +2.5 percent and thus more strongly than that of domestic guests (+1.9 percent). The weather favoured the demand for a holiday stay in Austria: average temperatures were in some cases well above the long-term average, while the majority of Austria was also characterised by persistent drought. The largest increases were in the number of overnight stays by guests from Poland (+11.2 percent), the Czech Republic (+10.8 percent), Hungary (+8.4 percent) and the USA (+6.8 percent). However, Germans, who by far account for the largest proportion of foreign guests in Austria (53 percent market share), also increased their tourism demand by 2.7 percent.

3.4 Above-average price increases for fuels, gastronomy and housing

Consumer price inflation accelerated to 2.2 percent in October. Prices continued to rise strongly in those two categories that have been causing above-average inflation in Austria for several years: the catering sector (catering services +3.1 percent) and the residential category (actual rentals for housing +3.4 percent). Due to the rise in the price of crude oil, expenditure on transport was also considerably higher than in the previous year (operation of private transport +7.9 percent). Energy inflation also had a stronger impact on housing in October (electricity, gas and other fuels +6.1 percent), after the effect in September had been slight. Together, the "transport", "housing, water, energy" and "restaurants and hotels" sectors contributed more than two thirds (+1.57 percentage points) to the overall inflation rate in October.

3.5 Decline in unemployment accelerated in November

Although the number of unemployed registered with the Public Employment Service Austria (AMS) increased in November compared to the previous month for seasonal reasons, it fell by 19,600 and 6 percent respectively compared to the previous year. Adjusted for seasonal fluctuations, the number of unemployed fell by 3,100 or around 1 percent compared with the previous month. The provisional estimate for the November unemployment rate was 7.6 percent. The supply of jobs was again expanded. The ratio of unemployment to vacancies thus fell further, seasonally adjusted to 4 unemployed per job vacancy. The number of persons in training increased again slightly in November, seasonally adjusted, after having declined in the last nine months. Seasonally adjusted employment grew again in November according to provisional data.

Employment and the number of vacancies reported to the Public Employment Service Austria (AMS) recently increased again in Austria.