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Mature Boom in Austria Amidst a Cooling World Economy

Business Cycle Report of November 2018

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The Austrian economy is in an advanced state of a boom. Labour market tightness is reaching a new high, solid income growth is supporting private consumption, and industrial activity is cooling in line with the global economy.

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The first half of October was characterised by tensions on the global financial markets and a noticeable decline in stock market prices. There are several reasons for this negative market development: in addition to the well-known issues such as the trade conflict between the USA and China, the dispute in the EU over Italy's budget, the oil price increase and the challenging Brexit negotiations, sobering business news recently came in. In the euro area, the economy grew by only 0.2 percent in the third quarter compared with the previous period. A special factor dampened the momentum in particular: production losses in the automotive industry, especially in Germany. These were attributable to the changes in emissions measurement and the delayed adjustment of companies to them.

Economic data from Austria were considerably more favourable. In the third quarter, the economy grew much stronger (+0.5 percent or +0.4 percent according to Eurostat standards) than the euro area average. However, the robust growth figures cannot hide the fact that manufacturing also lost momentum. Consumer demand and flourishing summer tourism proved to be stabilising factors. The income of private household was sustained by the favourable situation on the labour market. Employment continues to trend upwards and unemployment is falling. Labour market tightness (as measured by the inverse of the number of unemployed per job vacancy) is as high as it was the last time in 1989-1991. This tension on the labour market enables trade unions to make relatively high salary claims in current wage negotiations.

Inflation continues to be driven by the rise in housing rents and prices in the food service and hotel industry; the latter being overwhelmingly demand-driven given the flourishing value added in this sector. The third price driver were fuel and crude oil prices. They rose primarily because of US sanctions against Iran. In the run-up, they caused a considerable increase in the (speculative) demand for crude oil reserves,

while the slowing world economy and the expansion of global oil production had a dampening effect on the oil price.

1. Crude oil price fueled by speculative demand

At the beginning of October, crude oil costed as much as it did four years ago (86 \$ per barrel), the situation eased again in the course of the month. The rise in prices was largely driven by demand. However, the actual additional demand for crude oil is declining in line with the global economic slowdown, which tends to dampen the price of crude oil. According to a recent analysis by the Oxford Institute for Energy Studies, the speculative demand for crude oil was the determining factor for the price surge, i.e., the market expected a shortage of supply in view of the sanctions against Iran, which have also been applied to the energy sector since November, and crude oil reserves were increased. Thanks to the strong expansion of production volumes in Russia, the United Arab Emirates, Iraq and, above all, the USA, the price of crude oil did not rise any further and fell again in October.

2. US government escalates trade conflict with China

The lively consumer demand in the USA again contributed to very high economic growth in the third quarter (+0.9 percent compared to the previous quarter, +3.0 percent compared to the previous year). Inventories were also expanded sharply, however, probably because strong tariff increases are imminent at the beginning of 2019 (see below). In addition, import demand increased considerably, while exports declined. Industrial production rose by 0.3 percent in September compared with the previous month (+5.2 percent year-on-year). The losses in growth caused by Hurricane Florence were thus much smaller (less than 0.1 percentage point according to the US central bank) than those caused by the hurricanes in autumn 2017, which had dampened growth in industrial production by between ½ and 1 percentage point.

Consumer demand is booming in the USA.

On 24 September 2018, the US trade dispute with China reached a new escalation stage with the introduction of a 10 percent punitive tariff on consumer goods imports from China with a volume of 200 billion \$, following the previous day's 25 percent punitive tariff for 16 billion \$ of Chinese goods. In the course of the first half of 2019, almost all goods imported from China into the USA are likely to be subject to the threatened 25 percent penalty duty. It remains to be seen whether the US central bank will interpret the additional price pressure this will generate as temporary or if it will counter it with an additional tightening of monetary policy. In September it raised the range for the federal funds rate by 25 basis points to 2.00 percent to 2.25 percent as expected. The vast majority of the members of the Federal Open Market Committee, the monetary policy steering committee of the central bank, is anticipating another rate hike this year, and the expectation of three rate hikes in 2019 is now more substantiated.

3. Gloomy mood in the emerging markets

The moderate downward trend in the business sentiment of manufacturing companies in emerging markets since early 2018 continued in September. The main stress factors are the protectionist measures and the tightening of US monetary policy. In the two crisis countries Turkey and Argentina, the situation recently eased slightly. In Turkey, the central bank stabilised the lira by raising interest rates sharply, while Argentina and the International Monetary Fund reached agreement on an increase in the aid programme. Inflation in Argentina, however, has accelerated recently: in September, prices rose by 6.5 percent compared to August and by 40.5 percent compared to the previous year.

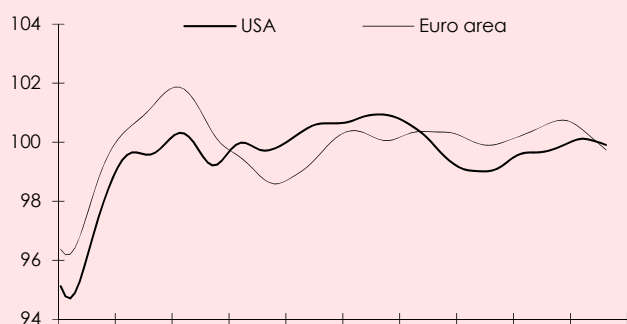
In China, the Purchasing Managers' Indices fell in October, with sentiment clouding in both the manufacturing and service sectors. Among other things, export orders developed weakly, which is probably attributable to the uncertainty caused by the trade conflict with the USA. The Chinese government is likely to respond to the

intensification of the conflict by boosting domestic demand in order to prevent a significant decline in growth.

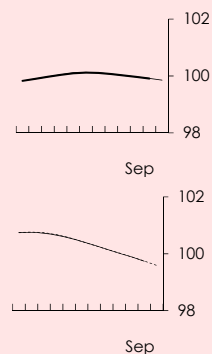
Figure 1: International business climate

Seasonally adjusted, 2015 = 100, 3-month moving average

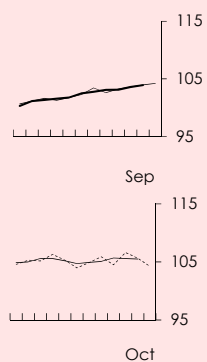
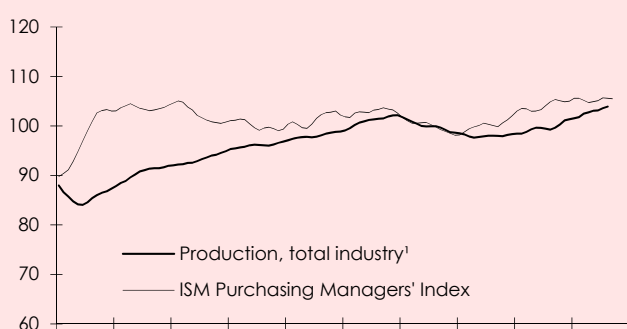
Leading indicators – amplitude



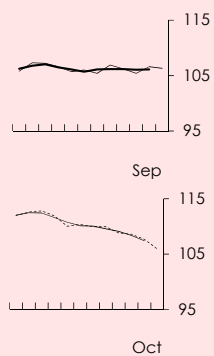
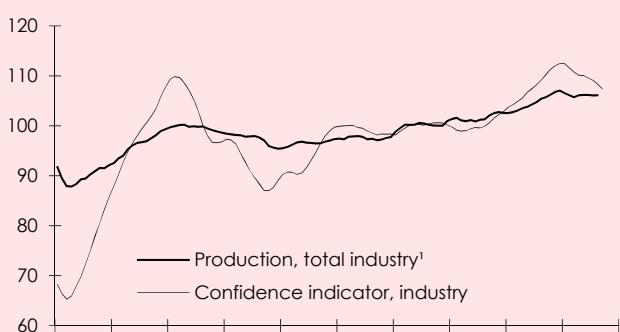
12-months performance



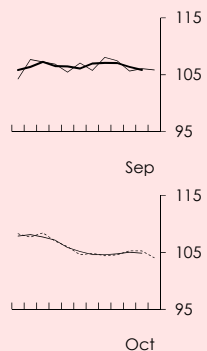
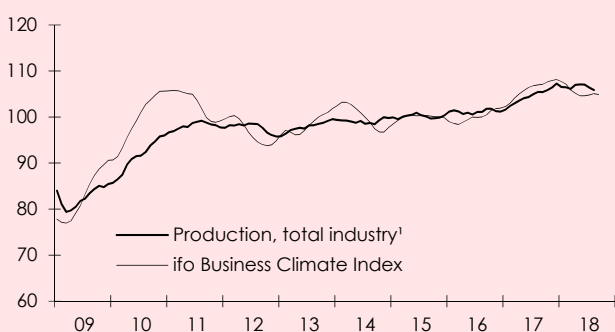
USA



Euro area



Germany



Source: European Commission, Deutsche Bundesbank, ISM (Institute for Supply Management™), ifo (Institute for Economic Research, Munich), OECD. – ¹ Excluding construction.

4. Economic momentum weakens in the euro area

Growth in the euro area slowed markedly in the third quarter of 2018. According to Eurostat's preliminary flash estimate, GDP exceeded the previous quarter's figure by only 0.2 percent. In France and Spain economic momentum was above average, in Italy the economy stagnated, and in Germany growth is also likely to have been below average. In the fourth quarter, corporate sentiment deteriorated. In October, the indicators for industry showed a less favourable picture than for the service sector. As the survey on the Purchasing Managers' Indices shows, the decline in export orders, in particular, was seen as a burden.

In October, according to first estimates, inflation in the euro area was just above the 2 percent threshold (2.2 percent), mainly due to the marked rise in energy prices. Core inflation remained subdued at 1.3 percent. The unemployment rate in September was 8.1 percent for the third time in a row. It was dampened by the decline in Italy, where the unemployment rate fell below 10 percent in August for the first time since the beginning of 2012; it rose again slightly in September. However, in line with the weak GDP development in the third quarter (see above), employment in Italy increased only moderately. Thus, this decline was probably less a sign of the economic recovery than rather a restriction of the labour supply, which may have different causes. France (9.3 percent) and Spain (14.9 percent) did not record a significant fall in the unemployment rate in September despite relatively strong economic activity.

Unemployment fell in the euro area, especially in Italy.

5. Germany: production losses in the automotive industry

The key industry in Germany, the automotive industry, was weak recently due to a special factor. Since September, all newly registered passenger cars have had to undergo certified measurements in accordance with the "Worldwide Harmonized Light-Duty Vehicles Test Procedure" (WLTP); this procedure replaces the "New European Driving Cycle" (NEDC) test routine, which had been in force in the EU since 1992. Since the German car manufacturers had not received approval in time for all vehicle types, production was massively reduced; Volkswagen even shortened the working week to four days. Although production losses are likely to be made up later, they slowed economic growth noticeably in the third quarter.

6. Economic growth in Austria still more dynamic than in the euro area

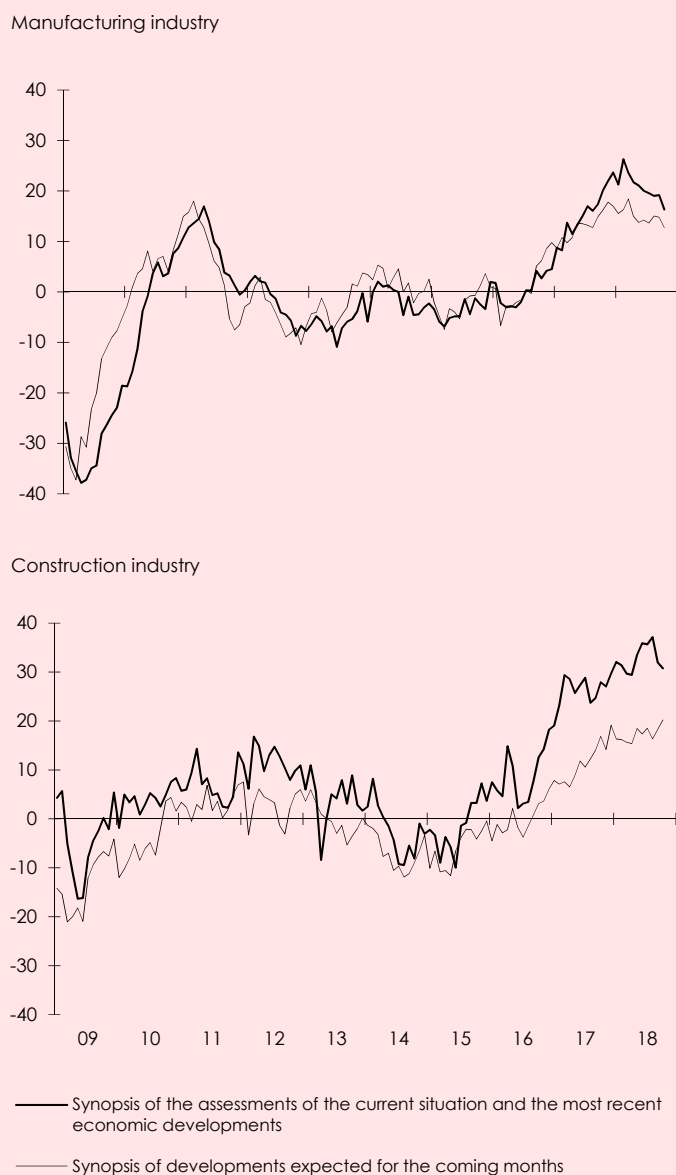
Having initially proved relatively resilient to the slowdown in the sector's growth in the euro area, the Austrian industry is now feeling the effects of the slowdown in global demand and tensions in world trade. In August, industrial production fell for the third time in a row (-0.8 percent compared to the previous month). According to the current WIFO Flash Estimate, value added in manufacturing expanded by only 0.6 percent in the third quarter compared to the previous period, after +1.0 percent in the second quarter and +1.4 percent in the first quarter. Export growth also slowed somewhat, although the associated dampening of imports limited the burden on GDP growth in the third quarter. Overall, however, export growth is increasingly providing less support for economic activity. Investment growth was also lower in the third quarter than in the first half of the year.

In Austria, industrial activity is also cooling down.

While exports and investments (expenditure side) and the production of goods (production side) lost momentum, consumer demand (expenditure side) and services (production side) had a stabilising effect. Private household demand expanded by +0.4 percent in the third quarter, just as strongly as public consumer spending. Market services (+0.7 percent) continued to make positive contributions to economic growth. At +0.3 percent, value added in the retail sector expanded largely unchanged compared with the first half of the year. The renewed strong increase in the accommodation and catering sector (+1.2 percent) continued to put pressure on prices from the demand side (see below).

Figure 2: Results from the WIFO-Konjunkturtest

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



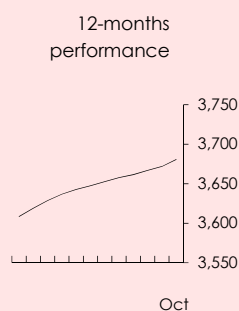
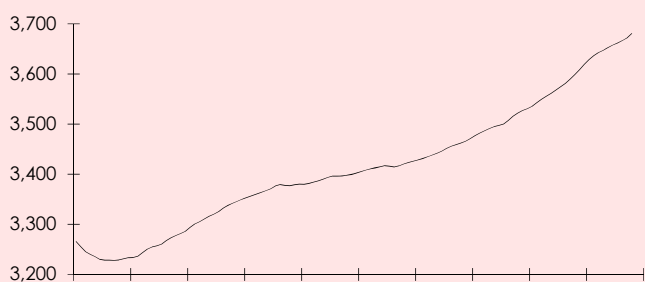
Source: WIFO-Konjunkturtest. Data refer to index points (percentage points) between +100 and -100. Values above 0 imply positive expectations, values below 0 indicate negative expectations.

6.1 Business sentiment clouding at a high level

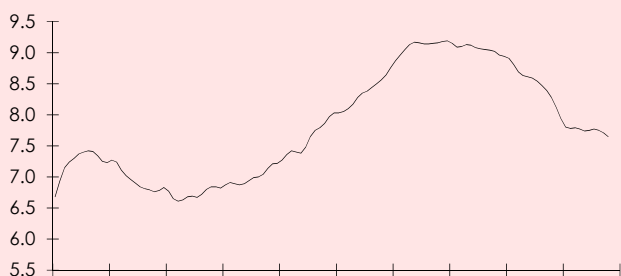
Similar to the rest of the euro area, business sentiment in Austria again deteriorated slightly at the beginning of the fourth quarter; however, it can still be regarded as optimistic. In the manufacturing sector, the majority of companies continued to report production increases, albeit to a lesser extent than in previous months. The order situation was again assessed somewhat more favourably and, according to the reports, capacity utilisation was also extraordinarily high at 86 percent. Accordingly, a shortage of labour (around 20 percent) and of materials and capacity (around 10 percent) were cited as the most important obstacles to production. 60 percent of the companies reported no barriers to production, 8 percent a lack of demand. In particular, however, expectations regarding the development of foreign orders clouded somewhat in October.

Figure 3: Key economic indicators

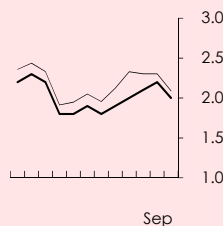
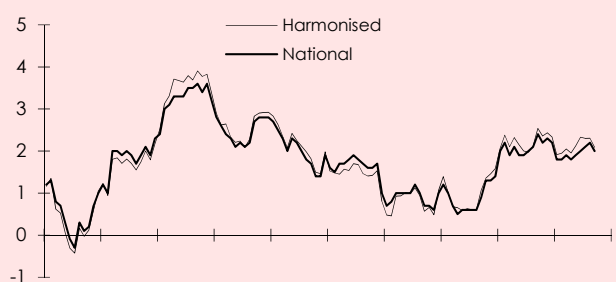
Persons in active dependent employment¹, 1,000s, seasonally adjusted



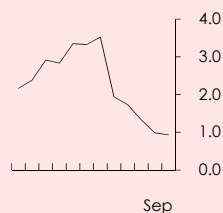
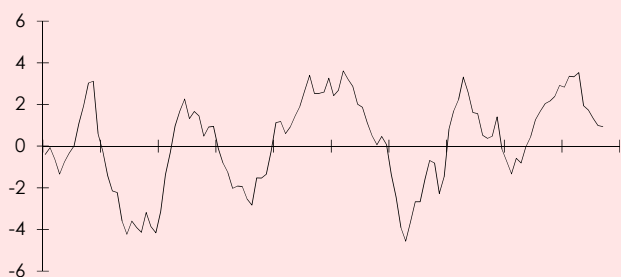
Unemployment rate, traditional Austrian method², seasonally adjusted



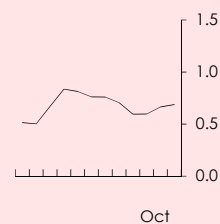
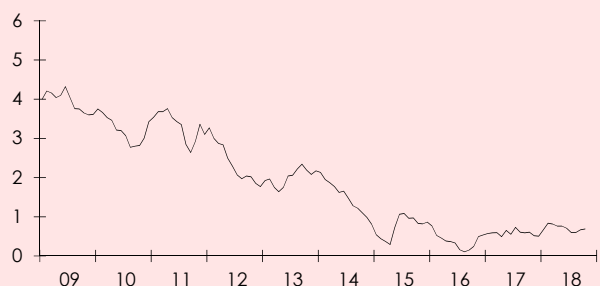
Consumer prices, year-to-year percentage changes



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.

6.2 Strong demand in summer tourism

In the first five months of the 2018 summer season, tourism in Austria recorded a nominal increase in turnover of 3.3 percent over the previous year. From May to September, around 68.6 million overnight stays were registered (+2.1 percent). More than two thirds of these were accounted for by foreign guests, whose demand rose by +2.3 percent and thus more strongly than domestic demand (+1.6 percent). The weather favoured demand for a holiday stay in Austria: average temperatures were in part well above the long-term average, and most of Austria was also characterised by persistent drought. Guests from Poland (+11.4 percent), the Czech Republic (+10.9 percent), Hungary (+7.1 percent) and the USA (+5.6 percent) recorded the strongest increases in the number of overnight stays. However, Germans, who by far account for the largest share of foreign guests in Austria, also increased their tourism demand by 2.6 percent.

6.3 Fuel costs, gastronomy and apartment rents drive up prices

Consumer prices rose by 2.0 percent in September. Prices rose sharply again in those two sectors that have been causing above-average inflation in Austria for several years: gastronomy (catering services +3.0 percent) and housing (rentals paid +3.6 percent). In addition, the rise in the price of crude oil led to a considerable increase in transport costs (operation of personal transport equipment +6.9 percent). Together, the sectors "transport", "housing, water, energy" and "restaurants and hotels" thus contributed more than half (1.24 percentage points) to the overall inflation rate in September.

6.4 Employment expansion at low job pressure

The seasonally-adjusted number of persons in active dependent employment increased by 0.1 percent in October compared with the previous month, while that of the unemployed fell by 0.4 percent. The number of vacancies was again strongly expanded, so that the seasonally-adjusted number of unemployed per job vacancy fell to 4. This figure has been so low only once since the 1980s, during the boom in the wake of German reunification. At that time, however, the unemployment rate was a good 2 percentage points lower than today. One reason for the simultaneity of low job pressure and still relatively high unemployment is the regional unequal distribution of unemployed and job vacancies. Recently, however, job offers have also been significantly expanded in the eastern Länder, which are more affected by unemployment than the west of Austria. In October, a total of around 296,000 unemployed persons were registered in Austria (7.3 percent of the employed labour force). By eliminating the additional seasonal workload, which in October still exists mainly in the construction sector, the figure would have been about 16,000 higher (7.7 percent of the employed labour force).

Labour market tightness in October was as low as at the beginning of 1992.