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High Energy Prices Weighing on Business Activity

The strong upward drift in energy prices is holding back further the already subdued private household demand in Austria. This is mirrored by the fragile business situation in retail trade and other service branches. Exports, manufacturing output and construction activity, for their part, enjoy somewhat higher rates of growth. Going forward, the business cycle currently shows no clear trend which explains the cautious attitude of corporate investors.

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The high energy prices are holding back business activity in the industrialised economies. Crude oil, on a euro basis, was 50 per cent more expensive in summer than last year. The price jump is fuelled by strong demand for oil in Asia and North America, but also by speculative behaviour. The shortage of refinery capacity in the USA, as a result of under-investment, is driving up prices for fuel and heating oil in all advanced economies. In the short term, consumers partly accommodate the high energy costs by lower savings, and only with a lag by restraining spending on other consumption. This undermines in particular economic activity in the euro area which for some time already has been suffering from sluggish private household demand. The US economy is less affected, since consumption is being sustained by high real estate prices and corporate investment remains lively.

GDP in the euro area in the second quarter edged up by only 0.3 percent in volume from the previous quarter and by 1.1 percent year-on-year. A higher momentum is not in sight for the next months, given the narrow income gains and the weakness of consumer sentiment. For Austria, too, the WIFO flash estimate yields an increase in real GDP of 0.3 percent in the second quarter, held back by sluggish consumer demand. The rise in contractual wages of 2.2 percent year-on-year for the period from January to July was below consumer price inflation, running at 2.6 percent. Although inflation eased somewhat over the summer under the impact of lower rent increases and cuts in telephone charges, the energy price hike is now reaching consumers, eating up a large part of the benefits from the latest tax cuts, as net real wages barely rise.

Against this background, the gain in retail sales of 1 percent in volume year-on-year in the first half of the year has been disappointingly small. Earnings of the tourism sector in the now ending summer season have probably risen at a similar rate. While the number of overnight stays in the months from May to July has slightly declined, by 0.3 percent from the previous year, tourists' daily spending has continued heading up, due to demand shifting in favour of city travel and towards accommodation of higher standard.

Better than with private consumption is the situation in the more export-driven sectors of the economy. Demand from the oil-producing countries is picking up significantly. Although growth of merchandise exports in Austria has decelerated from the high rates recorded last year, it was still close to 5 percent year-on-year in nominal terms in the period from January to June. The expansion is also reflected in the index of manufacturing output which in the first semester rose 5½ percent above the year-earlier level. The WIFO business survey of last August shows no clear trend for the manufacturing cycle. While judgements on the level of foreign orders weakened,

firms for the first time in several months expect a tentative pick-up in production and see the longer-term business outlook with less scepticism.

Investment in machinery and motor vehicles declined in the first half of the year. Early indications to that effect from the national accounts flash estimate are confirmed by the statistics showing a fall in imports of investment goods by an annual 9 percent between January and June. Results from the WIFO investment survey suggest that manufacturing companies plan to maintain their expenditure on capital goods at the high level of last year. The expiry of fiscal incentives, together with the uncertain business cycle outlook may induce many firms to hold back with new projects. Construction investment, for its part, is comparatively more buoyant, with demand rebounding particularly in civil engineering. According to the WIFO business survey, firms judge their order levels better than at any time during the last five years.

Lively construction activity has also had a positive impact on employment since last spring, as the continuous decline since 1997 in the number of construction jobs has come to a halt. New jobs have also been created in commercial services, trade and the public sector. The export industries, however, enjoying high productivity gains, are reducing their workforce. Although the total number of people in active employment is growing (+30,600 in August compared with last year), unemployment continues to rise at the same time (+12,500). The seasonally-adjusted unemployment rate edged up to 7.3 percent of the dependent labour force, or 5.1 percent of the total workforce according to Eurostat definitions.