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Growth Accelerated in Austria at Start of the Year

Business Cycle Report of June 2016

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Austrian real gross domestic product increased by 0.5 percent quarter on quarter in the first quarter of 2016, according to WIFO's latest quarterly accounts (based on the trend-cycle component). Having grown at a robust pace last year, economic activity thus accelerated further. The growth spurt was mainly driven by domestic demand. Leading indicators are painting a continually improving picture, but the general sentiment remains subdued.

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In the first quarter of 2016, the global economy expanded at a similarly modest pace as at the end of 2015. Economic activity in emerging market economies, having deteriorated markedly during 2015, appears to have recently stabilised. China's economic policy measures aimed at stimulating the economy likely had first positive results, while the recessive trends in Russia weakened. Among advanced economies, growth remained subdued notably in the USA at the start of the year, while it accelerated markedly in the euro area in the first quarter. Global economic growth is expected to pick up gradually in the coming months, fuelled mainly by ongoing robust developments in major advanced economies and the easing of the deep recessions underway in a number of large emerging market economies. This is also suggested by the most recent rise in commodity prices.

In Austria, growth accelerated noticeably at the start of 2016. This increase is remarkable, given the lacklustre global economic activity and the rather bleak picture painted by leading indicators for Austria. The expansion was driven by domestic demand. Especially consumption grew vigorously in the first quarter of 2016; both private and government consumption increased by 0.3 percent. Gross fixed capital formation (including machinery and equipment and construction investment), at +0.6 percent in the first quarter also contributed positively to GDP growth. Net trade once again did not make a positive contribution to economic growth, as the increase in imports outpaced that in exports.

Inflation has eased further recently. CPI inflation, at +0.5 percent in April 2016 (March +0.7 percent) fell to its lowest level since October 2009 (+0.2 percent). Employment growth continued in May, with the seasonally adjusted number of persons in dependent active employment rising by 1,900 compared with the previous month. Compared with a year before, the number of persons employed rose by 50,000 or

1.5 percent. The unemployment rate (seasonally adjusted) stood at 9.2 percent in May.

1. Subdued growth of world economy

In the first quarter of 2016, the global economy expanded at a similarly modest pace as in the fourth quarter of 2015. Signs emerged of a shifting of the forces of economic growth: following a noticeable slowdown in many emerging market economies last year, activity seems to have stabilised there recently. In China, for instance, efforts to stimulate the economy appear to have had first positive results. In Russia, the downward momentum weakened. By contrast, economic growth in a number of major advanced economies remained subdued. This may be partly attributable to a feedback effect of the sluggish demand in emerging market economies. However, the almost stagnant economy in the USA in the first quarter also had domestic causes. In the euro area, by contrast, the overall economic recovery proceeded at a more vigorous pace, supported by the mild winter weather.

1.1 Developments uneven across emerging market economies

The Chinese economy grew at a robust pace in the first quarter of 2016, although growth rates weakened somewhat over the last quarters. The expansion was primarily supported by investment, notably in public infrastructure and real estate. The situation in financial markets appears to have stabilised – the outflow of foreign-exchange reserves slowed considerably, and stock price volatility eased markedly.

Brazil, which had experienced sharp falls in activity, recently saw the recessive trends weakening. Real GDP shrank by 0.3 percent quarter on quarter in the first quarter. On a year-on-year basis, GDP declined by 5.5 percent. The ongoing contraction of the Brazilian economy at the start of the year had already become apparent before then. But the activity indicator of Brazil's central bank (Índice de Atividade Econômica do Banco Central) declined further in the first quarter, and industrial production also decreased again considerably on a seasonally adjusted basis compared with the fourth quarter of 2015. Capital goods production plummeted by almost one third. The marked political uncertainty is regarded as the key driver behind the collapse; it may have heightened further as a result of the recent escalation of the state crisis. The inflation rate (CPI) has fallen slightly from high levels in recent months (April 2016 +9.3 percent), but it is assumed that the inflation target of Brazil's monetary policy will be exceeded noticeably also in the coming months. Against this background, the central bank recently left the key interest rate unchanged at 14.25 percent.

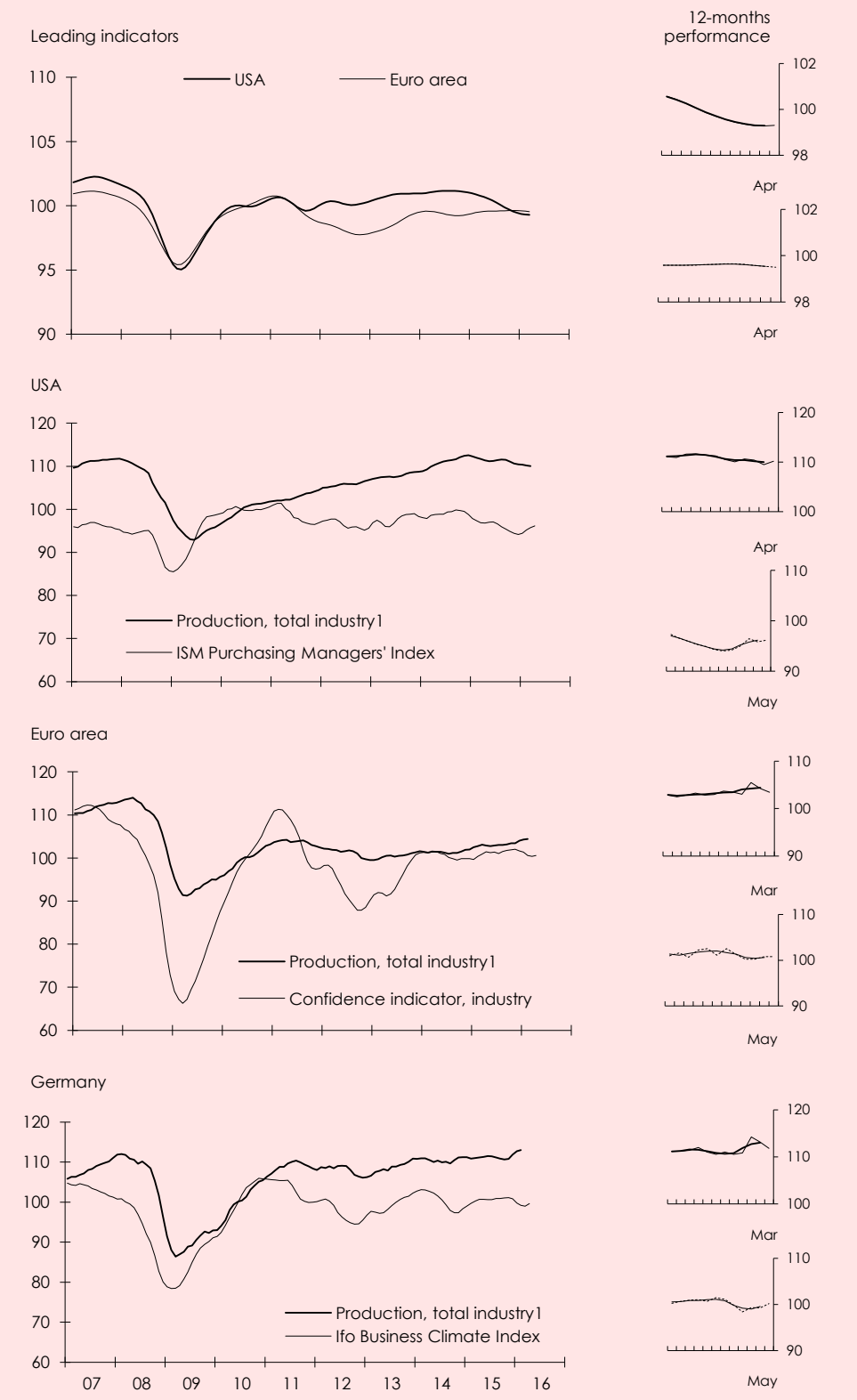
In Russia, the recessive trends appear to have weakened recently. In the fourth quarter of 2015, real GDP was still considerably lower than a year before. This gap decreased markedly in the first quarter of 2016, according to a government estimate (seasonally adjusted data are currently not available). Should the most recent crude oil and commodity market recovery prove to be sustainable in general, the contraction of the real economy is expected to come to an end by year-end.

In East Central Europe, economic growth slowed in the fourth quarter of 2015 and the first quarter of 2016, with real GDP even contracting on a seasonally adjusted quarter-on-quarter basis in Hungary and Poland in the first quarter. Nevertheless, the underlying upward trend of economic activity in the region is assumed to be intact. This is suggested by progressively improving labour market conditions, among other things: in recent months, the unemployment rate has fallen in all countries of the region, with Poland and the Czech Republic recently registering a decline to levels recorded before the outbreak of the global financial crisis, and Hungary recording a rate lying already clearly below that level. In addition, weak consumer price developments are strengthening private households' purchasing power and consumption.

The global financial market turbulence observed in the spring has eased since then, the excessive volatility has declined, and commodity prices have also rebounded. This has contributed to an easing of overall financial conditions in many emerging market economies. In an environment of an increased readiness to take risks, the latter are again registering higher capital inflows, which are also connected with a marked appreciation of the currencies of these countries, among other things.

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.

1.2 USA experiences dip in activity

In the USA, the upward trend slowed further at the start of 2016. Seasonally adjusted real GDP rose by 0.2 percent compared with the fourth quarter of 2015, according to the second official estimate. This slowdown can on the one hand be attributed to

the corporate sector's marked investment restraint, especially in the oil industry. On the other hand, activity was dampened by the merely tepid expansion of private consumption, with increases in household expenditure falling short of income gains. However, private consumption is expected to provide a growing positive impetus in the coming months; in April, household expenditure, at +1.0 percent, rose at a surprisingly vigorous pace. In real terms, the increase was also brisk (+0.6 percent). Hence the strong consumption momentum in April is expected to prompt a marked acceleration of economic growth in the second quarter. In May, the unemployment rate dropped to 4.7 percent. Its downward trend is a result not only of continued robust employment growth but also of a slight decline in the labour market participation rate.

1.3 Significant acceleration in activity in euro area

The recovery in the euro area continued at the start of 2016. Real GDP grew by 0.6 percent, seasonally adjusted, in the first quarter of 2016 compared with the previous quarter, and by 1.7 percent compared with a year before. This acceleration in growth was observed in most countries of the euro area. In France, the recovery strengthened, with GDP rising by 0.6 percent quarter on quarter. Private consumption grew at a particularly vigorous pace, following the setback in the fourth quarter. In Italy, by contrast, the situation improved only slightly, with output expanding by 0.3 percent on a seasonally adjusted basis. Given a growth rate of 0.8 percent, the brisk recovery proceeded at an unchanged pace in Spain, fuelled also by a renewed sharp pickup in building investment. So far, the heightened political uncertainty has not had any noticeable negative impact on the economy. Economic developments in the other euro area countries were also largely positive. However, the situation remains tense in Greece, where the measures introduced within the framework of the adjustment programme continued to weigh especially on private consumption.

2. Brisk growth of Austrian economy at start of 2016

The Austrian economy grew briskly in the first quarter of 2016: according to the most recent quarterly accounts, the trend-cycle component of real GDP, at +0.5 percent quarter on quarter increased more strongly than in the second half of 2015 (fourth quarter +0.3 percent, third quarter +0.2 percent). In the first quarter of 2016, unadjusted GDP exceeded the year-earlier level by 1.6 percent; adjusted for calendar effects (leap day, number of working days), the increase was 1.1 percent. This increase is remarkable, given the rather subdued global economic activity and the rather bleak picture painted by leading indicators for Austria.

Buoyant consumption was the main driver behind the surge in growth. Both private and government consumption increased by 0.3 percent. In the first quarter, growth in household spending clearly exceeded the average quarterly growth rates recorded in the three previous years (2013-2015 +0.1 percent). This surge in demand was likely a consequence of the renewed fall in crude oil prices (compared with the previous quarter), which boosted Austrian households' purchasing power. In addition, consumer demand benefited from the good employment situation and improved income developments owing to the tax reform. The increase in government consumption was determined by the rise in spending on refugees.

A positive contribution to GDP growth also came from gross fixed capital formation (including machinery and equipment and construction investment), which rose by 0.6 percent in the first quarter. The demand for machinery and equipment picked up by 0.8 percent. Austrian companies once again increased their investment in machinery and vehicles. A positive stimulus was also provided by construction investment: especially non-residential construction increased markedly (+1.1 percent), while residential construction growth remained subdued.

Although moderating somewhat, the positive underlying momentum observed in foreign trade continued. Both exports (+0.5 percent) and imports (+0.7 percent) rose more slowly than had been the case since spring 2015. Notably goods exports

Following modest growth last year, the expansion in Austria accelerated markedly in the first quarter of 2016. Growth was driven by domestic demand: both consumption and investment increased further. Net exports, by contrast, dampened GDP growth.

slowed, while services exports increased strongly, owing to the favourable development of tourism. As the increase in imports outpaced that in exports, net trade once again did not contribute positively to economic growth.

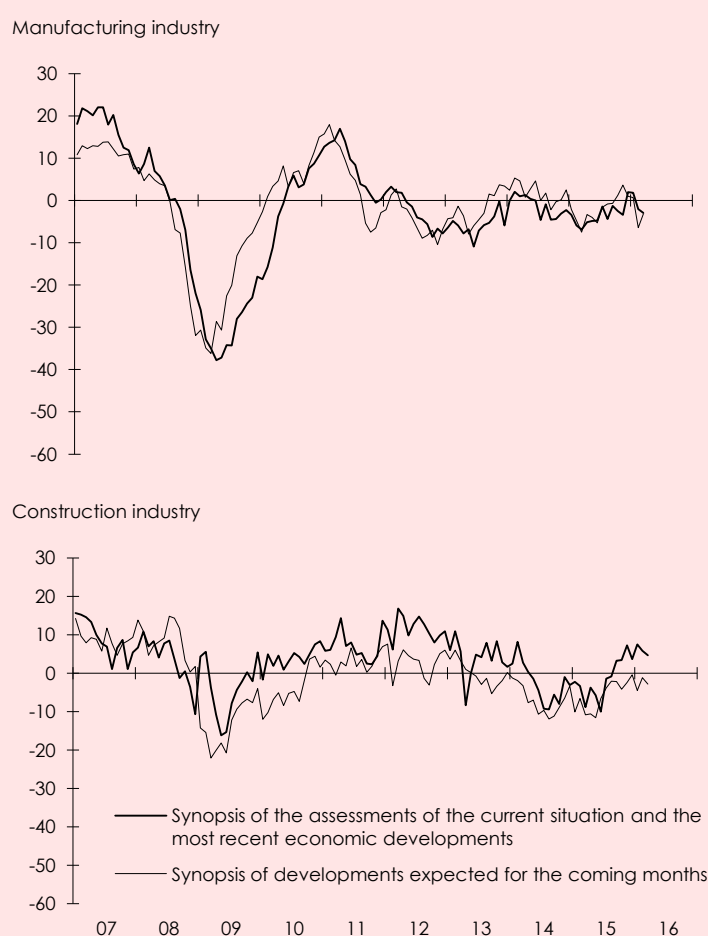
2.1 Improvement of Leading Indicators amid subdued sentiment

WIFO's Business Cycle Survey of May shows a slight improvement in Austrian firms' recently weak assessments of economic conditions. The index for the total economy of firms' assessments of the current situation rose noticeably. This increase was mainly attributable to firms in the services sector, while companies in manufacturing, a sector of great importance for economic activity, remain mostly sceptical about the current situation. The index also declined in the construction sector, but remained in positive territory.

While the picture painted by leading indicators is progressively improving, the general sentiment remains rather subdued.

Figure 2: Results from the WIFO Business Cycle Survey

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



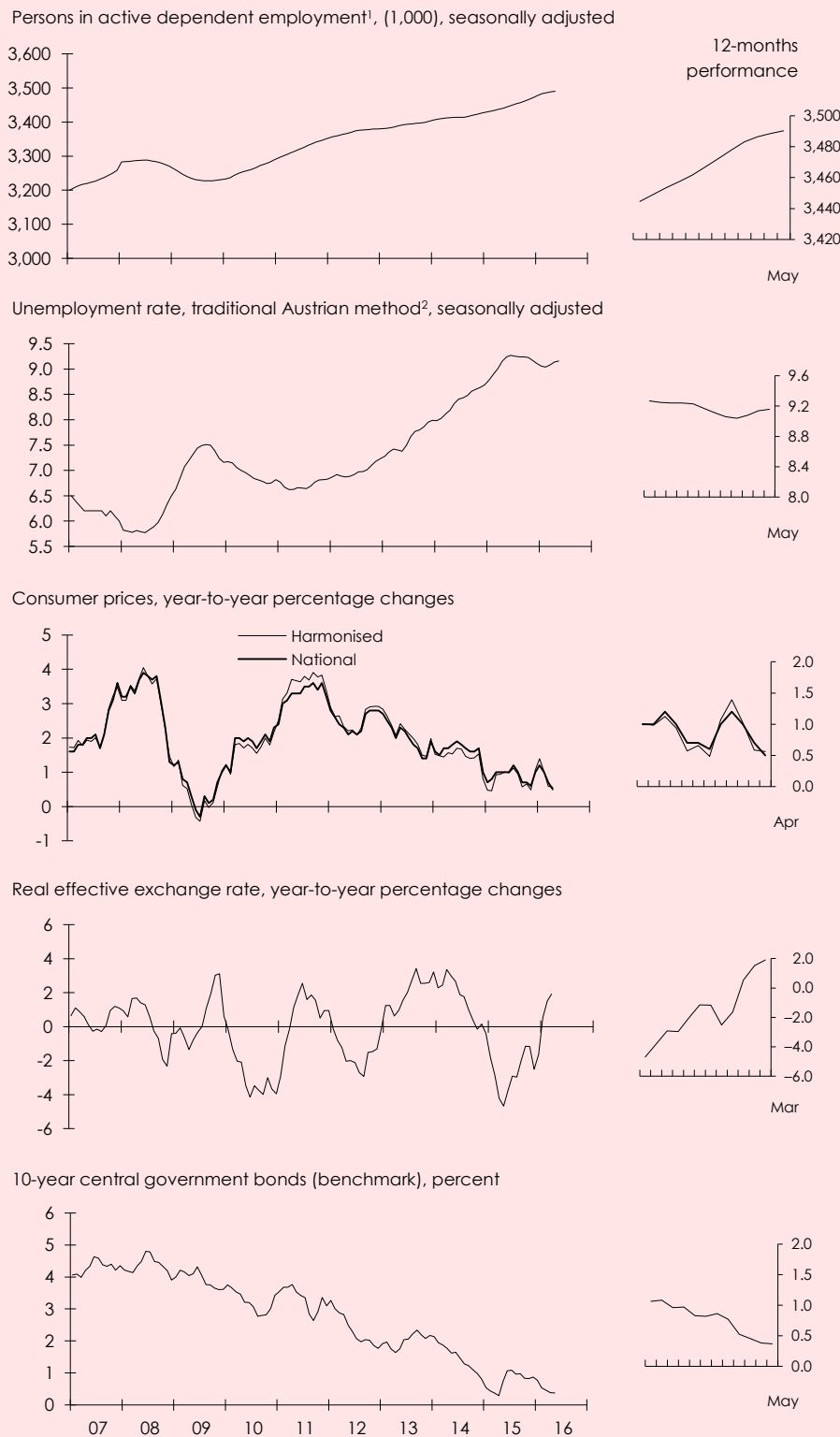
Source: WIFO Business Cycle Survey. Data refer to index points (percentage points) between +100 and -100. Values above 0 imply positive expectations, values below 0 indicate negative expectations.

The business expectations index, which had been falling since November 2015, improved for the first time compared with previous months. The results point to somewhat more optimistic expectations of Austrian companies also across sectors. In the manufacturing industries, the expectations index improved a little in May, but remained in negative territory, while in construction it turned positive. As in the case of the index of assessments of the current situation, the highest increase in the expectations index was registered in the services sector.

The Bank Austria Purchasing Managers' Index, at 52 points in May as in the previous month signalled a continuation of the modest growth of the Austrian industry. The

indicator has exceeded the growth threshold of 50 points already for more than one year now. However, for the first time since the summer of 2015, price trends point to a deteriorating cost situation for firms.

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.

2.2 Strong pick-up in tourism sales in winter season

In the 2015-16 winter season, the Austrian tourism industry recorded a year-on-year sales increase of 2.9 percent (+2.1 percent in real terms, in each case adjusted for the special effect of the leap day), according to provisional calculations. Overall, the number of nights spent from November 2015 until April 2016 rose by 3.0 percent (also adjusted for the effect of the leap day), with the demand from non-resident travellers growing more briskly than that from resident guests.

Extraordinarily sharp increases (unadjusted) in nights spent were registered not only by Alpine Länder such as Salzburg or Vorarlberg, but regions with tourist offers other than winter sports also registered above-average increases in demand (Vienna, Burgenland). Developments in Styria were in line with the average for Austria. Owing to the good snow situation in March and April 2016, Carinthia's tourism sector almost made up for the gap existing until February vis-à-vis the average for Austria.

Austria's tourism industry recorded increases in nights spent in all major source markets (notably Sweden, Czech Republic, USA and Belgium) in the 2015-16 winter season (unadjusted). The demand from guests from Romania, Poland and France grew at a much more subdued pace. The Russian market collapsed also in the 2015-16 winter season, owing to the economic crisis and the EU sanctions.

2.3 Inflation continues its slight slide

The inflation rate fell to +0.5 percent in April 2016 (March +0.7 percent), according to calculations by Statistics Austria, the lowest rate recorded since October 2009 (+0.2 percent). The largest upward impact came from the "restaurants and hotels" expenditure category (+3.3 percent), largely as a result of price increases for services related to catering services (+3.4 percent). The prices of accommodation services rose by 2.3 percent compared with a year before.

Prices in the "housing, water, energy" expenditure category remained almost flat (+0.3 percent). Rents did rise by 2.7 percent, but expenditure for housing maintenance and repair increased by just 0.9 percent, and household energy was even 3.3 percent cheaper on average compared with a year before (district heating -0.8 percent, gas -0.2 percent, electricity +1.1 percent), owing to the sharp fall in heating oil prices (-24.2 percent).

The prices in the "transport" category also declined (-3.6 percent). Fuel prices (-13.5 percent) continued to have the largest dampening effect, albeit less so than in March.

2.4 Labour market developments marked by repeated setbacks

Employment grew further in May, with the number of persons in dependent active employment increasing by 1,900 (seasonally adjusted) compared with the previous month, or by 50,000 or 1.5 percent compared with a year before.

The number of persons unemployed, which had been declining since October 2015, has been rising again slightly since March 2016 (in seasonally adjusted terms, April +2,700, May +1,200 month on month). Most recently, 360,600 persons (seasonally adjusted) were registered as unemployed, an increase of 0.3 percent from the previous month. In May, the unemployment rate stood at 9.2 percent (seasonally adjusted).

Leading indicators for the labour market suggest that demand will continue to develop favourably. For instance the demand for labour of industrial enterprises may rise further in the coming months. This is suggested by the high level of the sub-indicator for employment of the Bank Austria Purchasing Managers' Index. The number of job vacancies registered with the Public Employment Service is also on the rise owing to the pick-up in economic activity. But as the sharp increase in the supply of labour continues unabated, the somewhat more positive economic development is not yet reflected in a sustained decline in unemployment.

The Austrian labour market recently continued the trend observed in previous months. Further employment gains were accompanied by a slight increase in unemployment (in both cases on a seasonally adjusted basis).