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Confidence Indicators Near All-time Highs

Business Cycle Report of May 2017

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A revival in global industrial activity is spreading from East Asia, intensified by the recovery in Russia and Brazil. It noticeably benefits Austrian exports and industrial production. Leading indicators suggest that the positive development will continue. Both national and international sentiment indicators have reached peaks not seen in several years.

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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", <http://www.wifo.ac.at/wwadocs/form/WIFO-BusinessCycleInformation-Glossary.pdf> • Cut-off date: 8 May 2017.

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ISSN 1605-4709 • © Austrian Institute of Economic Research 2017

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

Global economic activity has gained considerable traction in recent months. The demand for imports has increased vigorously especially in East Asia, but strengthening demand from Russia and Brazil has also been contributing to the upswing. Global industrial production continued to expand in February, driven by impetus provided by advanced as well as emerging market economies. Alongside the pickup in international demand, commodity prices rose again more sharply in the first quarter.

The USA, by contrast, saw growth decelerate in the first quarter. Notably private household expenditure, a driver of growth in previous quarters, grew only modestly. However, the slowdown may be partly attributable to seasonal adjustment issues and may therefore have been less pronounced than shown. Labour market conditions remain good. Sentiment indicators did deteriorate slightly in April, but remain at consistently high levels.

Growth of the Austrian economy accelerated in the first quarter. According to WIFO's Flash Estimate, GDP expanded by 0.6 percent compared with the previous quarter. Measured according to Eurostat guidelines (i.e., including the irregular component), growth in Austria was 0.5 percent, which was consistent with the euro area average. While the momentum observed at the end of 2016 was sustained in the euro area, growth weakened slightly in the EU as a whole. The UK registered economic growth of 0.3 percent.

Against the backdrop of accelerating international activity, Austrian companies benefited from strengthening export demand in the first quarter. As a result, industrial activity also picked up. Private household consumption once again proved an important pillar of growth.

National and international leading indicators from consumer and business surveys already signalled favourable developments in the first quarter. They have been rising

for several months and in April reached record highs in many sectors. Therefore economic activity is expected to remain lively in Austria as well as in the euro area and the EU as a whole, although the actual development is not as dynamic as survey results suggested.

In WIFO's Business Cycle Survey, Austrian firms continued to give an optimistic assessment of current economic conditions, and WIFO's Leading Indicator also rose further in the April analysis. The increase in the European Commission's consumer confidence indicator suggests a marked improvement in consumer confidence for Austria. The good spending mood is also reflected in buoyant business in the trade sector. The positive effects of the tax reform, which supported trade and consumption in 2016, appear to have continued into the first quarter. This also becomes apparent in the ongoing robust demand for consumer durables at the start of 2017.

In the tourism sector, however, unfavourable snow conditions, coupled with negative calendar effects, dampened the preliminary result for the 2016-17 winter season.

Inflation in Austria accelerated in the first quarter, mainly owing to the upward pressure exerted by crude oil and other commodity prices. After a 2.2-percent increase in the CPI in February, inflation receded slightly to 2.0 percent in March. Apart from fuel prices, components in the "restaurants and hotels" expenditure group also continued to have a strong upward impact.

Owing to lively economic activity, labour market conditions improved further. In April, the number of persons in dependent active employment increased at a similar pace as in March (+1.9 percent, year on year, according to Federal Ministry of Labour, Social Affairs and Consumer Protection estimates). At the same time the number of unemployed persons declined. In April, 337,923 persons were registered as unemployed with the Public Employment Service (AMS). The seasonally adjusted unemployment rate according to the Austrian method of calculation was 8.7 percent in April, unchanged from the previous month.

1. Global economy gathers further momentum

World trade activity is gaining further traction. After a mere +1.3 percent in 2016 (according to CPB), growth in the volume of world trade has been picking up since the end of 2016, except for a dent in February. International trade grew again more briskly especially in emerging market economies, where activity had slackened last year. Global industrial production also expanded further, with impetus provided not only by advanced, but also by emerging market economies. In Latin America, a growing amount of evidence points to an economic recovery; according to CPB, trade activity has increased in recent months. The OECD's leading indicator for Brazil has been signalling an end of the recession for some time now. This upward trend is expected to have positive effects on economic activity in other Latin American countries, too. In East Asia, the dynamism of imports (according to CPB) also increased significantly at the start of the year.

China's economy continues to be marked by a deceleration in real growth owing to structural factors, which is now being driven primarily by private consumption. At the same time the share of services in GDP is rising. Following +6.7 percent in 2016, the Chinese economy continued to grow at a strong rate (+6.9 percent) in the first quarter of 2017. A remarkable acceleration was registered for nominal economic growth in the first quarter: at +11.8 percent, the rate was the highest in five years. This probably illustrates dynamics in China better than real GDP figures do, on the one hand because demand fluctuations in an economy with a high level of utilisation and strong underlying momentum are more likely to have an effect on prices, and on the other hand, because the figures shown for real economic growth are assumed to orientate themselves along the explicit government targets. Commodity prices have also been rising again at last on the back of a strengthening global economy. The HWWI Index of World Market Prices of Commodities, which comprises food, beverages and tobacco as well as energy and industrial raw materials, has been trending upward since the beginning of 2016 in euro terms. Compared with a

Emerging market economies are also experiencing a beginning economic recovery.

year before, momentum accelerated further at the beginning of 2017 (average for January and February +67 percent, year on year), but then eased somewhat (average for March and April +37 percent, year on year). The prices of industrial raw materials have also been rising more strongly since the end of 2016, given the brisker expansion of the global economy; here, too, the upward trend weakened in March compared with a year before.

1.1 Slowdown in US growth in the first quarter

Real GDP growth in the USA weakened in the first quarter of 2017 (+0.2 percent, after +0.5 percent in the fourth quarter of 2016), according to the first advance estimate. Notably private household spending, a driver of growth in previous quarters, grew only modestly. Real income losses owing to price increases for energy at the start of the year may have played a role here. At the same time net trade did not contribute to economic growth. However, brisker growth of fixed capital formation (construction and equipment investment) provided a positive impetus in the first quarter.

The notoriously weak growth of the US economy in the first quarters in recent years may also be attributable to shortcomings with respect to seasonal adjustment, however. In the past, seasonally adjusted GDP data still contained some remaining seasonality. Driven by lively investment activity, the underlying momentum of the total economy remains positive, despite its most recent weakening. Industrial activity accelerated in March. Overall, industrial production increased by 1.5 percent compared with a year before. The labour market also continues to perform robustly; the unemployment rate fell further in April, to 4.4 percent.

Sentiment indicators declined from high levels in April. The ISM Purchasing Managers' Index, deteriorated recently, after having risen since the end of 2016, but at 54.8 percent still remained above the 50-percent threshold that indicates an expansion of the economy. After having trended steadily upward, consumer confidence also weakened slightly in April, according to the Conference Board as well as Reuters and the University of Michigan. This may also still reflect lagged effects of the acceleration of inflation at the beginning of the year. Inflationary pressures eased again slightly in March, with the inflation rate falling to 2.4 percent (after 2.7 percent in February). Expenditure on energy and especially fuel has declined recently.

1.2 Stable growth in the euro area and the EU as a whole

Economic growth in the euro area and the EU as a whole was robust at the beginning of 2017. According to Eurostat's Flash Estimate, quarter-on-quarter GDP growth was 0.5 percent in the euro area in the first quarter, and 0.4 percent in the EU. Hence the growth momentum observed at the end of 2016 was sustained in the euro area, while the EU as a whole experienced a slight slowdown. In the UK, the economy expanded by 0.3 percent. Sentiment indicators improved further in April, reaching new peaks in almost all sectors. In April, the European Commission's Economic Sentiment Indicator rose to the highest level on record since summer 2007 in both the euro area and the EU as a whole. The Business Climate Indicator (BCI) and the Purchasing Managers' Index for the euro area also increased sharply in April, reaching their highest levels in seven and six years, respectively.

The European Commission's latest Consumer Confidence Indicator also shows a further improvement in consumer confidence in both the euro area and the EU as a whole. Here, consumption is also supported by the continued improvement in the labour market. The number of unemployed persons declined further in March compared with a year before, and at 9.5 percent in the euro area and 8.0 percent in the EU as a whole, the unemployment rates were the lowest in about eight years.

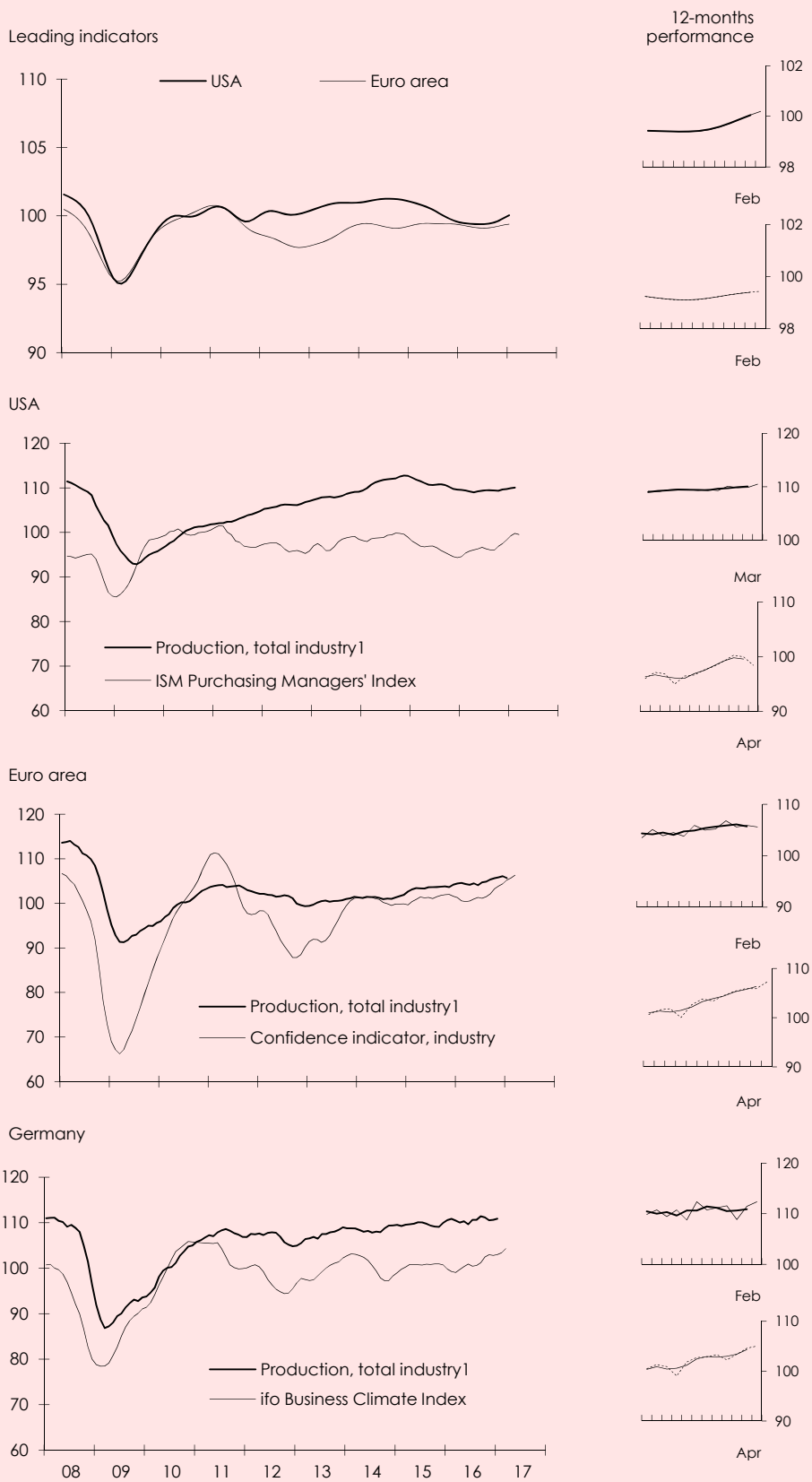
Following modest price increases in 2016, inflation accelerated noticeably in the euro area in the first quarter of 2017. This development was largely determined by the low levels of crude oil and energy prices at the beginning of 2016. After having reached 2 percent in February, the highest reading in more than four years, inflation declined to 1.5 percent in March. According to Eurostat's Flash Estimate it is assumed to have increased again to 1.9 percent in April.

US growth slowed as a result of private households' lower willingness to purchase goods.

Leading indicators for the euro area and the EU as a whole reached record highs, suggesting that economic activity will remain lively.

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.

1.3 German companies remain very optimistic

In Germany industrial activity remains robust. The steady upward movement, observed last year, continued at the beginning of this year. Along with the positive export momentum illustrated by the foreign trade figures for January and February, this suggests a good GDP result in the first quarter. Retail sales also grew robustly from January to March.

Sentiment indicators maintained their exceptionally high levels, but again, the realised figures do not quite show the dynamism exhibited by the survey levels. In April, the assessment of the current situation according to the ifo Business Climate Index, for instance, was only slightly lower than its highest level on record. The European Commission's confidence indicators also improved further for both consumer confidence and industry.

2. Austria: acceleration of economic activity in first quarter

Austria's GDP expanded by 0.6 percent, quarter on quarter, in the first quarter of 2017, according to WIFO's Flash Estimate (trend-cycle component)¹. Hence economic activity has accelerated steadily since mid-2016. Compared with a year before, unadjusted GDP grew by 2.0 percent. The number of working days in the first quarter exceeded last year's by 2.5 (despite the leap day in February 2016); this provided further support to the strong growth compared with last year.

External trade gathered momentum at the start of the year. For the first time since the second half of 2014, quarterly growth was no longer driven exclusively by domestic demand, but also by net trade. Quarter-on-quarter export growth (+2.1 percent) outpaced the rise in imports (+1.8 percent). In January, for which first foreign trade statistics data are already available, nominal goods exports grew very briskly (+9.4 percent, working day adjusted, goods imports +2.9 percent, year on year). Exports to EU-28 countries picked up markedly. A positive impetus also came from Latin America and Russia.

Private consumption maintained the strong growth momentum also in the first quarter of 2017, with personal consumption expenditure (including that of non-profit institutions serving households) increasing by 0.4 percent, quarter on quarter. The positive income effects of the tax reform, which had supported consumption in 2016, appear to have persisted into the first quarter, too. The demand for consumer durables, for instance, remained very robust at the start of 2017, in particular the demand for passenger cars: in the first quarter, registrations of new passenger cars increased by 12.8 percent, compared with a year before.

The expansion of investment also supported economic growth. The demand for gross fixed capital formation (investment in machinery and equipment and construction investment as well as other investment) increased by 0.9 percent, quarter on quarter, at a similar pace as in previous quarters. Apart from investment in production capacities, construction investment also regained momentum after a decline in the third quarter of 2016.

The upturn in industrial activity has recently accelerated. Manufacturing value added grew by 1.8 percent, quarter on quarter (fourth quarter +0.4 percent). The construction industry also posted an increase in the first quarter of 2017 (+0.4 percent, quarter on quarter), following a decline in the second half of 2016. Market services once again also supported economic growth. Retail trade benefited from rising disposable income, population growth and the improvement in labour market conditions.

Following a phase of weakness in 2016, net trade supported GDP growth again for the first time in Austria.

¹ The indicator as measured according to Eurostat guidelines, which also contains the irregular component, rose by 0.5 percent.

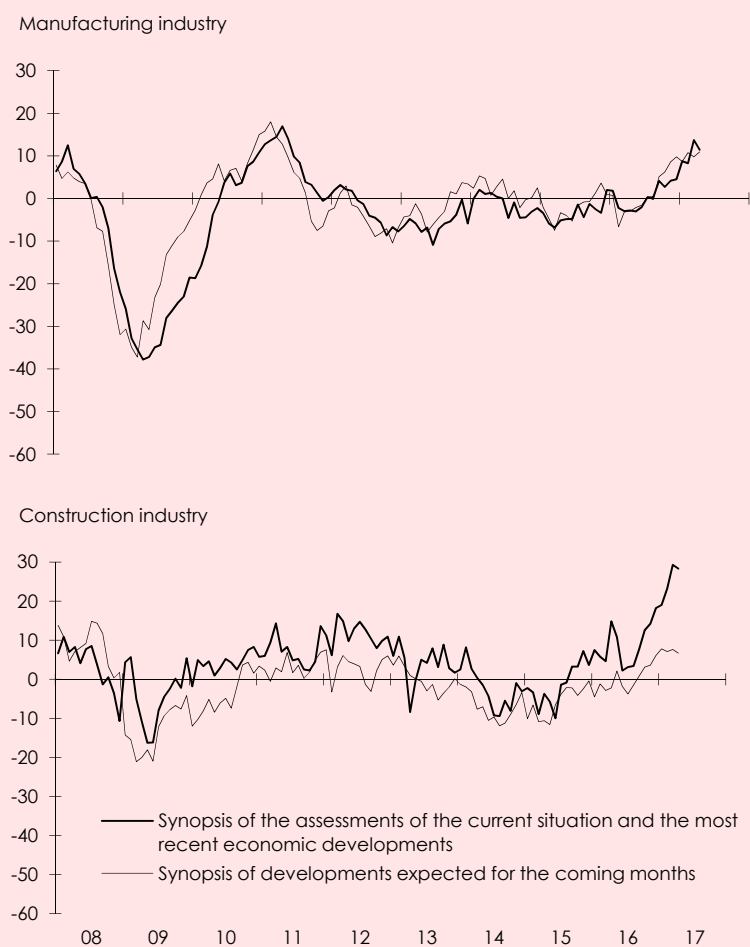
2.1 Sentiment indicators very optimistic

Following an acceleration of industrial activity in the first quarter, leading indicators suggest that this positive development will continue. In WIFO's Business Cycle Survey of April, companies continued to give an optimistic assessment of economic activity. In April, the index for the total economy of firms' assessment of the current situation was almost unchanged from a month before, and its reading was the highest on record since June 2007. Firms' expectations also remained optimistic. WIFO's Leading Indicator increased further in the April analysis.

Leading indicators suggest that industrial activity will remain buoyant in the second quarter.

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.

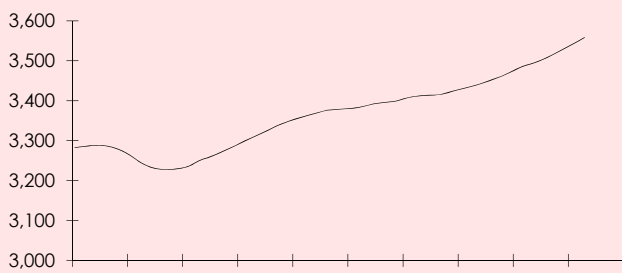
The Bank Austria Purchasing Managers' Index also reached its highest level in six years (58.1 points). Both domestic and foreign order levels improved substantially compared with the previous month.

2.2 Weaker tourism result expected for the winter season

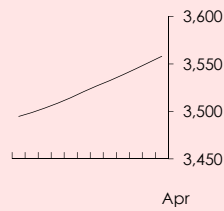
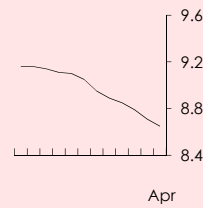
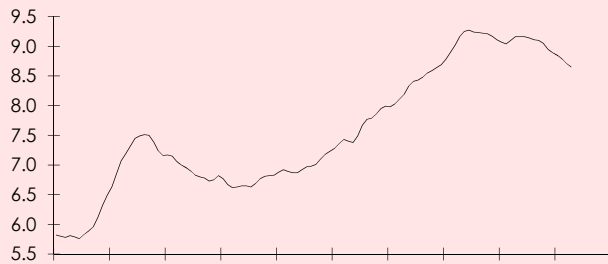
One month before the end of the 2016-17 winter season, preliminary results show a decline in sales in both nominal and real terms compared with a year before. The result was also dampened by calendar effects (leap day in February 2016, later timing of Easter in 2017). Adjusted for these effects, nominal sales posted a slight increase of 0.3 percent, while real sales declined by 1.5 percent compared with a year before.

Negative calendar effects and unfavourable snow conditions have so far dampened tourism sales during the winter season.

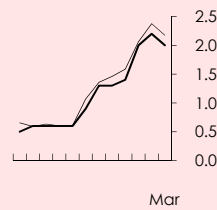
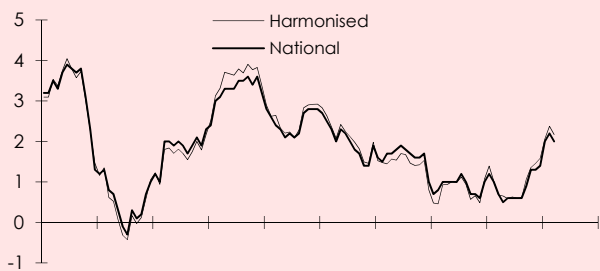
Figure 3: Key economic indicators

Persons in active dependent employment¹, (1,000), seasonally adjusted

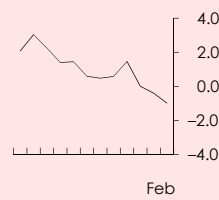
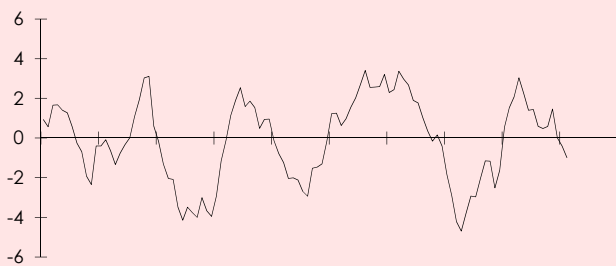
12-months performance

Unemployment rate, traditional Austrian method², seasonally adjusted

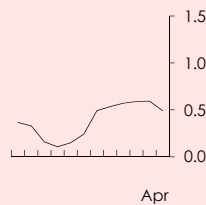
Consumer prices, year-to-year percentage changes



Real effective exchange rate, year-to-year percentage changes



10-year central government bonds (benchmark), percent



Source: Public Employment Service Austria, Federation 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.

The number of overnight stays (not adjusted for calendar effects) declined by 4.0 percent in the period from November 2016 to March 2017, compared with the same period a year before. This can be attributed primarily to a drop in foreign tourist arrivals (-5.1 percent), which account for 77.5 percent of total demand. The demand for overnight stays by domestic guests, at +0.2 percent only just exceeded the (unadjusted) year-earlier level. The preliminary result for the 2016-17 winter season was affected not only by calendar effects, but also by unfavourable snow and weather conditions in early and late winter. This dampened particularly the demand in the winter sports regions in Tyrol, Vorarlberg, Salzburg and also Carinthia.

2.3 Inflationary pressures on the rise in first quarter

CPI inflation has accelerated since the start of the year, to 2 percent (January and March) and 2.2 percent (February), respectively, once again driven by fuel price developments. Moreover, upward impacts on inflation came from the "restaurants and hotels" expenditure group. Excluding expenditure on fuels and restaurants, the inflation rate would have been 1.3 percent in March.

Sharp price increases in the "restaurants and hotels" group continue to significantly influence the inflation differential between Austria and the euro area average. The EU-wide harmonised inflation rate was 2.2 percent in March for Austria, once again higher than the euro area average of 1.5 percent.

2.4 Ongoing improvements in labour market

The favourable cyclical conditions are also reflected in ongoing improvements in the labour market. In April, employment growth maintained almost the same strong momentum (+1.9 percent, year on year, according to Federal Ministry of Labour, Social Affairs and Consumer Protection estimates). On a month-on-month seasonally adjusted basis, the increase also remained steady (+0.2 percent).

At the same time the number of unemployed persons declined further, compared with both a year before (-16,000) and the previous month (-2,000 persons). In April, 337,923 persons were registered as unemployed with the Public Employment Service. Including persons enrolled in training programmes, 413,683 persons were without a job.

According to the Austrian method of calculation, the seasonally adjusted unemployment rate was 8.7 percent in April, the same as in March.

Following modest price pressures until autumn 2016, inflation accelerated further at the beginning of 2017.