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Business Sentiment Improved

Business Cycle Report of February 2013

Leading indicators point to a slowdown in the pace of the economic downturn in Austria and the EU overall. Uncertainty among businesses and private households is gradually diminishing. In Austria, economic activity remained subdued at the end of 2012. While industry and trade activity were sluggish, sales gains were reported by the tourism industry.

For definitions of terms used, see "Methodological Notes and Short Glossary", in this volume and <http://www.wifo.ac.at/wfadocs/form/WIFO-BusinessCycleInformation-Glossary.pdf> • All staff members of the Austrian Institute of Economic Research contribute to the Business Cycle Report. • Data processing: Christine Kaufmann, Martha Steiner • Cut-off date: 6 February 2013. • E-mail address: Sandra.Bilek-Steindl@wifo.ac.at

World trade and global industrial production are slowly beginning to stabilise, notably as a result of the accelerating economic momentum registered in Asia's emerging economies. Following a phase of weakness, China's economy again expanded at a robust pace at the end of 2012. By contrast, the pace of activity in advanced economies has remained lacklustre lately. Japan's economy is in recession, US GDP stagnated in the fourth quarter of 2012 compared with the previous quarter (in part owing to special effects).

In the EU, industrial production has recently declined at a slower pace. The results of the European Commission's Business Survey conducted at the beginning of 2013 suggest that economic activity is on an upward trend. This holds true for almost all sub-sectors (services, construction, trade, and private consumption). Notably Germany saw business sentiment improve noticeably in January. In the fourth quarter of 2012, economic activity had still been subdued, as the latest industry, export and retail data show.

In Austria, too, the latest results from WIFO's Business Cycle Survey reflect a marked improvement in business expectations, though negative responses still outnumber positive responses. WIFO's latest leading indicator paints a similarly positive picture of the short-term business outlook.

Manufacturing activity was still sluggish at the end of 2012, with the production index declining once again in November compared with the previous month. Exports also fell again in October (seasonally adjusted) in the context of weak economic activity in Germany and the other EU countries.

While the tourism industry posted marked sales gains in the first two months of the winter season, retailers reported a decline. However, both consumers and retail firms are more optimistic about future prospects, according to recent survey evidence.

The inflation rate stood at 2.8 percent for the third consecutive month in December. While the upward drift in prices was largely caused by price increases in the housing, water and energy, as well as food categories, the contribution of mineral oil products to overall inflation has been declining continuously of late.

In January, employment growth slowed down compared with a year earlier (persons in dependent active employment +0.7 percent). At the same time the number of unemployed persons rose further: in January, 338,421 persons were registered as unemployed, an increase by 20,394 from January 2012. The seasonally adjusted unemployment rate remained unchanged at 7.2 percent.

World Trade (according to Centraal Planbureau CPB) is slowly stabilising (November three-month moving average +1 percent compared with the previous period). This is largely attributable to the expansion of foreign trade by emerging Asian economies, while the decline in advanced economies continues.

China appears to have overcome the phase of weakness experienced in the first half of 2012. Increased infrastructure investment and the stabilisation observed in the residential construction sector have recently provided support to the economy. Economic growth remained robust at +2.0 percent quarter-on-quarter in the fourth quarter of 2012. Leading indicators released at the beginning of 2013 suggest that the expansion will continue: both the manufacturing Purchasing Managers' Index (according to HSBC) and the OECD's Composite Leading Indicators have again risen steadily in recent months. Real GDP grew by 7.8 percent in 2012 (after +9.3 percent in 2011), the lowest increase since 1999. Apart from the global economic slowdown and the weak demand in 2012 associated with it, this deceleration in growth can increasingly be attributed also to structural changes (medium-term tertiarisation of the economy).

Japan's economy remains mired in recession. Activity in the export sector and in industry is subdued in the absence of stimulus from other advanced economies. Exports fell sharply in the third quarter of 2012. The Tankan leading indicators published by Japan's central bank fell yet again at the end of 2012, rendering a recovery in the months ahead not very likely. To support the economy, the central bank decided to ease monetary policy yet again and introduced an open-ended asset-purchasing programme. Against the backdrop of persistent deflation, the medium-term inflation target was raised from 1 to 2 percent.

Economic activity in East-Central Europe remains sluggish, industrial production (according to CPB) is declining. The Russian economy grew only modestly last year. Tighter credit conditions and a restrictive fiscal policy are dampening domestic consumption and investment demand.

Much the same as world trade, the expansion of global industrial production has recently been supported exclusively by emerging economies in Asia, Latin America and the Middle East. On a three-month moving average basis, industrial production increased by 0.2 percent month-on-month in November. While emerging economies saw production grow by 2 percent, advanced economies experienced a decline by 1.8 percent.

In the USA, GDP stagnated in the fourth quarter compared with the previous quarter, according to first advance estimates. This development constitutes the first pause in growth since the upswing began in March 2009 and is likely a result also of special effects: government expenditure, especially defence spending, declined sharply in the fourth quarter, after a vigorous expansion in the third quarter. Likewise, the unusually massive liquidation of inventories contributed negatively to growth. By contrast, both personal consumption expenditure and equipment and residential investment increased in the fourth quarter. In 2012, real GDP grew by 2.2 percent.

Industrial production expanded in November and December, probably also owing to catch-up effects and damage repair work after Hurricane Sandy hit in October. Industrial capacity utilisation has again risen recently. It stood at 78.8 percent in December, 1.5 percentage points below its long-term average (1972-2011).

Leading indicators are sending out contradictory signals for the short-term outlook. While, according to Thomson Reuters/University of Michigan, consumer confidence improved again in January after declining in December, it deteriorated again recently, according to the Conference Board. Private households gave a more pessimistic assessment than previously of their personal financial situation, probably also in the face of the expiry of the reduced Social Security payroll tax rate 2011-12. Hence the Conference Board Index is back again at the level recorded at the end of 2011.

World trade supported by demand from emerging asian economies

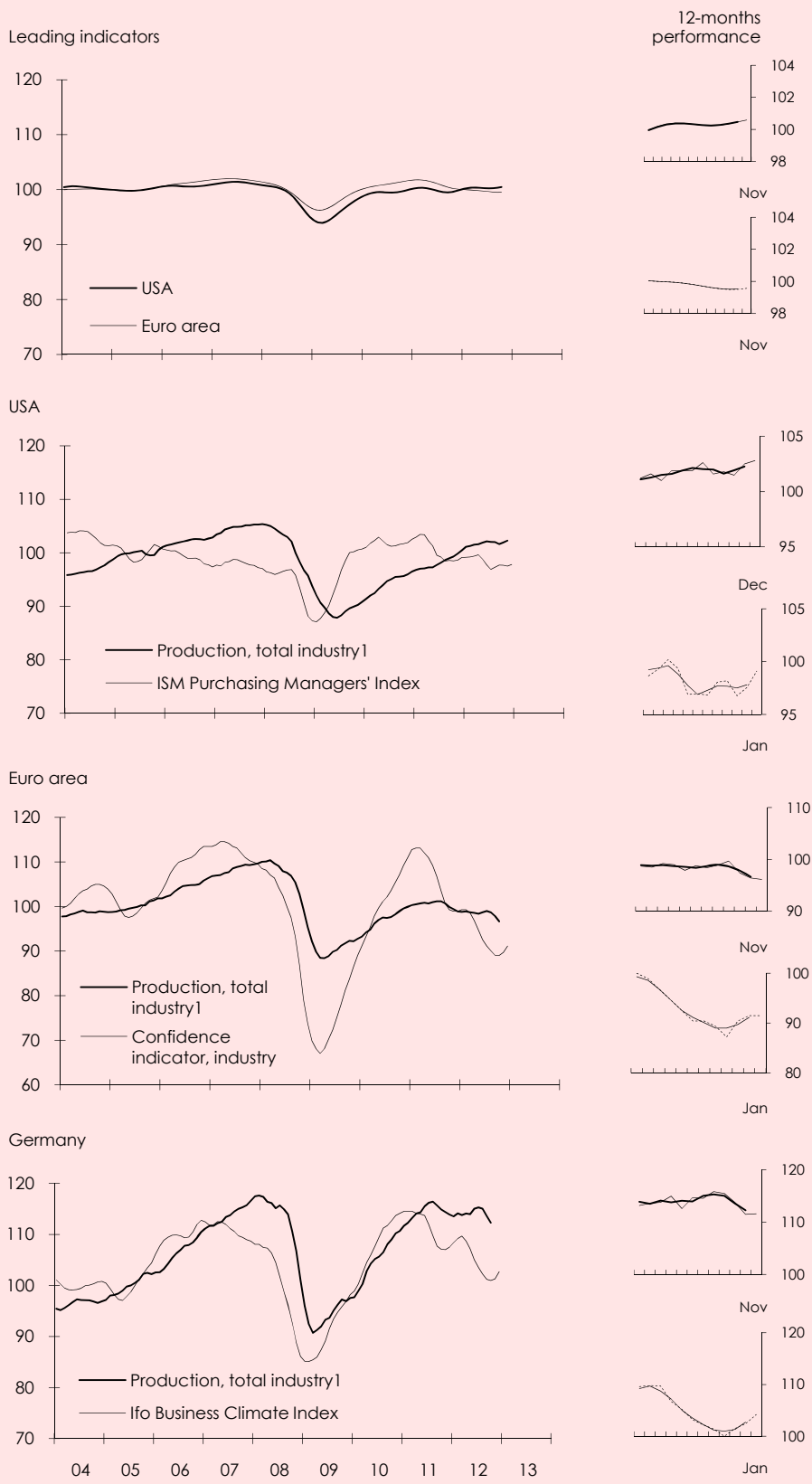
World trade and global industrial production are gradually beginning to stabilise, owing to impulses from emerging Asian economies. Demand in advanced economies continues to be lacklustre. Japan's economy remains mired in recession.

Contradictory signals from USA

In the USA, GDP stagnated in the fourth quarter of 2012 compared with the previous quarter. But this development was most likely attributable to special effects rather than to a cyclical slowdown. Leading indicators provide diverging signals for the short-term economic outlook.

Figure 1: International business climate

Seasonally adjusted, 2005 = 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.

Businesses have been considerably more optimistic of late. The Purchasing Managers' Index (PMI), which in recent months had been close to the 50-point mark (a reading above 50 indicates that economic activity is expanding), rose again sharply, to 53.1, in January. Positive signals are coming from the real estate market: Standard & Poor's Case-Shiller Index increased for the tenth successive time in November 2012, and is now back again at the level recorded in autumn 2010.

Industrial production stabilised on EU average in November 2012, and in seasonally adjusted terms was only 0.3 percent below the level recorded a month earlier (October -0.8 percent). The production of capital goods, which is relatively sensitive to cyclical developments, expanded by 0.5 percent. The prospects for the first quarter of 2013 have also improved, according to the European Commission's most recent business surveys. Firms were more optimistic in their assessment of new orders and also expressed greater optimism in their expectations regarding the outlook for exports in the coming months. Capacity utilisation in the manufacturing sector, which had been declining since mid-2011, rose again in January.

Confidence in the economy (Economic Sentiment Indicator) has been growing since November 2012. However, the indicator still remains below its long-term average. When looking at the large EU countries, a mixed picture emerges: the strongest positive impulse was provided by Germany, while the indicator stagnated in Italy and declined in France and Poland.

Consumers' assessment of their future financial situation has also become more optimistic on EU average recently. Pessimism about labour market trends has declined significantly, notwithstanding persistently high unemployment in some countries. The seasonally adjusted unemployment rate stood at 10.7 percent in December 2012, while a year before it had still been 10.0 percent. 20 of the 27 EU countries registered an increase in their unemployment rate at the end of 2012 compared with a year before. A sharp rise from an already high level was recorded in Greece (October 2011: 19.7 percent, October 2012: 26.8 percent), Cyprus (December 2011: 9.7 percent, December 2012: 14.7 percent) and Spain (December 2011: 23.2 percent, December 2012: 26.1 percent).

Since the ECB agreed on a government-bond-buying programme, risk premiums in peripheral countries have been falling. Owing to gained trust, governments can slowly turn again to capital markets for refinancing.

Euro area inflation stood unchanged at 2.2 percent in December. The sub-indices having the largest upward impacts on headline inflation were fuels for transport and electricity as well as vegetables. The lowest inflation rates were recorded in Greece (0.3 percent), France and Cyprus (1.5 percent each), the highest in Finland (3.5 percent) and Estonia (3.6 percent).

The HWWI Index of World Market Prices of Commodities, which comprises the prices of food, drink and tobacco as well as energy and industrial raw materials, dropped by 2.0 percent in dollar terms in January compared with a year before, especially as a result of a steadying of prices in the food, drink and tobacco category, which had been very high last year. The prices of crude oil and industrial raw materials have picked up again somewhat recently, but have remained below their year-earlier levels. The price of Brent crude averaged \$ 113.7 per barrel at the end of January 2013 (calendar week 4).

The euro-dollar exchange rate, after rising further lately, averaged \$ 1.33 in January.

The German economy grew by 0.7 percent in 2012. Activity moderated markedly particularly in the latter half of the year. GDP is assumed to have contracted in the fourth quarter compared with the previous quarter. Foreign trade, once again the most important driver of growth in 2012, also lost momentum at the end of 2012 (November -3.4 percent, seasonally adjusted, compared with the previous period).

EU industrial production gradually stabilising

Production is declining at a slower pace in the EU. Leading indicators suggest that economic activity will continue to improve. However, unemployment remains extremely high, especially in peripheral countries.

Further easing of financial and commodity markets

Hardly any dynamics in Germany at end of 2012

Likewise, industrial production rose only marginally in November (production index +0.1 percent).

Retailers posted a decline in sales at the end of 2012 (December -4.7 percent in real terms, year-on-year); however, there were two selling days less in December 2012 compared with a year before. Compared with the previous month, sales dropped by 1.7 percent on a seasonally adjusted basis.

Leading indicators point to an acceleration of economic activity at the beginning of 2013: The Ifo Business Climate Index rose for the third consecutive time in January, with notably firms' business expectations improving markedly.

Manufacturing activity in Austria was again lacklustre at the end of 2012. The production index, which had stagnated in October, fell again in November (-1.5 percent). This was also reflected in foreign trade: in an environment of weak economic activity in Germany and the EU as a whole, exports dropped again in October (-1.6 percent, seasonally adjusted, compared with the previous month). Cumulated exports from January to October 2012 declined by 2.3 percent, cumulated imports rose by 1.3 percent compared with the same period a year before.

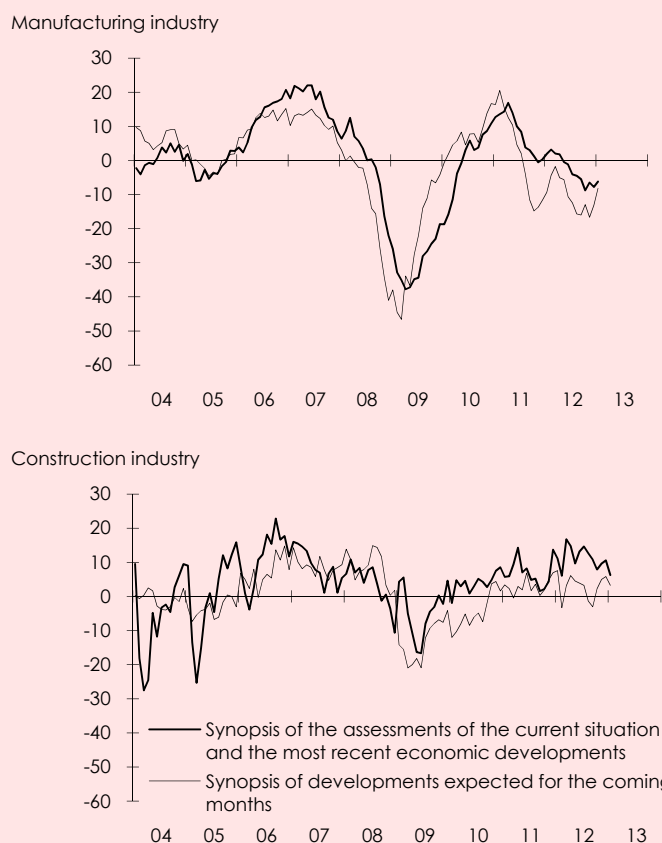
Following a weak fourth quarter, leading indicators released at the beginning of the year suggest that the German economy is stabilising.

Austria: business confidence slowly growing

Following lacklustre activity in the export sector and in industry at the end of 2012, the outlook for Austria's economy based on leading indicators has recently improved.

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.

Evidence from the WIFO Business Cycle Survey conducted in January 2013 suggests that economic conditions are slowly stabilising. While negative appraisals continued to outnumber positive responses when firms were asked to assess the current situation, this trend has not deteriorated further since late summer. A marked improvement was recently registered in the business expectations index, although here, too, negative responses still predominate. The fact that uncertainty among businesses is

slowly subsiding also becomes apparent in manufacturers' expansive investment plans reported in WIFO's latest investment survey. Construction firms, however, do not plan to invest more in 2013 than they did last year.

WIFO's latest leading indicator also presents a positive picture. Having reached its nadir in October 2012, it has been rising since November. Recently it has increased substantially on a month-on-month basis, owing to the improvement in the majority of its sub-components. A pick-up in economic activity in the first half of 2013 has therefore become more likely.

Activity in the retail trade and motor vehicle trade sectors was also lacklustre in the fourth quarter of 2012. The number of new passenger car registrations for private households declined again recently. Retail sales (excluding motor vehicles) in part also remained far below their year-earlier levels, both in nominal and real terms. Hence, the retail sales results for the 2012 Christmas holiday season (with 2 selling days less) did not reach the record results achieved in 2011. The decline in sales was broad-based across nearly all sectors. This unfavourable development is also reflected in the results of the WIFO Business Cycle Survey for the retail trade: firms' assessment of current business conditions deteriorated each month from August until the end of 2012 (except in November). In the January survey, respondents gave a more positive assessment both of current business conditions and of the outlook for the coming months. Likewise, consumer confidence improved slightly at the beginning of 2013 after declining in autumn 2012, notably because consumers' assessment of the economic outlook for the coming 12 months has become considerably more optimistic.

At +7.7 percent according to provisional calculations, tourism sales posted a substantial increase in November and December 2012 compared with the same period a year before. Real sales increased by 4.8 percent in the first two months of the winter season. The number of nights spent rose by 7.3 percent overall (foreign travellers +9.4 percent, domestic travellers +2.3 percent). This relatively strong increase was in part attributable to the favourable timing of the holidays in December and to booming city tourism.

Following weak growth in 2010 and 2011, the number of nights spent increased markedly at +4 percent in the 2012 calendar year. Sales also recovered and rose at a rate of around 4½ percent on average for the year as a whole. In real terms, sales rose by 2½ percent, after having contracted every year without exception since 2009.

In the foreign source markets of importance to Austria, above-average increases were recorded in the first third of the 2012-13 winter season in the number of nights spent by guests from Russia (+26.0 percent), the Netherlands (+18.6 percent), Belgium (+13.1 percent) and Germany (+10.3 percent). The demand from Switzerland (+9.0 percent), the UK (+6.9 percent) and Hungary (+6.6 percent) also grew vigorously. The number of nights spent by guests from the USA (+0.6 percent) and Italy (-0.7 percent) remained broadly flat, while that by guests from the Czech Republic (-3.6 percent), France (-4.2 percent) and Poland (-6.1 percent) declined.

The inflation rate stood at 2.8 percent for a third consecutive month in December. The increase in the Harmonised Index of Consumer Prices (HICP), at 2.9 percent once more exceeded the euro area average (2.2 percent). Overall, the upward drift in prices observed in December can largely be attributed to price increases in the housing, water and energy as well as food categories. The prices of mineral oil products settled down, compared with previous months. Excluding food, inflation would have been only 2.3 percent, whereas excluding mineral oil products it would have stood at 2.7 percent. The price of diesel fuel fell by 1.6 percent, that of four-star petrol by 0.9 percent, month-on-month, in December 2012; by contrast, apartment rents rose by 0.5 percent from the previous month.

Retail sales declined at end of 2012

Retail sales declined at the end of 2012 owing to weak household demand. However, both consumers and retailers are now more optimistic in their assessment of the economic outlook.

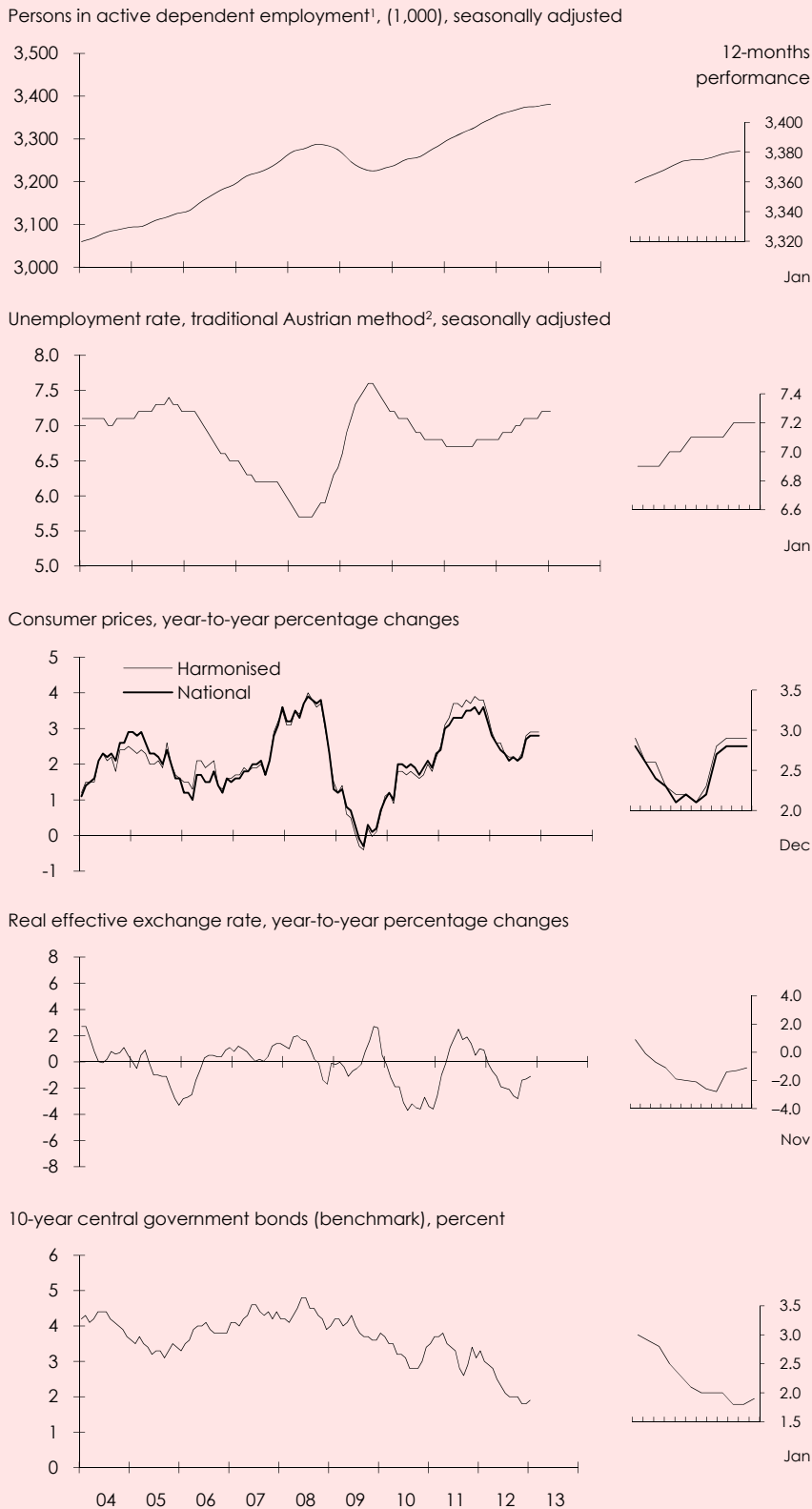
Tourism: substantial gains posted in the first two months of the winter season

Inflation still high in December

Inflation has been accelerating substantially since September 2012. Price increases for mineral oil products have become increasingly less important in this context.

Real estate prices also picked up markedly over the course of 2012. Since the beginning of 2012, the real estate price index according to OeNB (Austrian National Bank) has risen at a two-digit rate compared with a year before.

Figure 3: Key economic indicators



Source: Public Employment Service Austria, Federation of Austrian Social Security Institutions, Oesterreichische Nationalbank, Statistics Austria, WIFO calculations. – ¹ Excluding parental leave, military service, and unemployed persons in training. – ² As a percentage of total labour force excluding self employed, according to Public Employment Service.

Year-on-year employment growth slowed in January (persons in dependent active employment +0.7 percent, after +0.9 percent in December 2012). Compared with a month before, the number of persons employed once again remained flat (on a seasonally adjusted basis). The number of job vacancies registered with the Public Employment Service dropped further in January (-2,416 compared with a year before). At the same time the number of unemployed persons continued to rise: in January, 338,421 persons were registered as unemployed, an increase by 20,394 from January 2012. The number of persons enrolled in vocational training programmes also continues to rise. In January, a total of 26,364 more people were without jobs than a year before.

The unemployment rate according to the Austrian method of calculation came in at 9.1 percent in January 2013, an increase by 0.5 percentage point from a year before. In January, negative seasonal effects weighed on the unemployment rate, which in seasonally adjusted terms was 7.2 percent.

Economic weakness weighing on labour market