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## Cloudier Business Outlook

**Business activity has clearly lost momentum since the beginning of the year. Stimulus from exports, which has supported economic growth last year, is fading, while private household demand is still not showing the hoped-for recovery. The business climate in manufacturing has weakened, albeit not as much as in the euro area. Only the tourism and the construction sectors see their situation improving. The rate of inflation is barely falling, due to high energy prices and a number of domestic factors, and unemployment remains on an upward trend.**

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Merchandise exports in the first quarter were up by only 2½ percent from last year in nominal terms (compared with +11½ percent in the fourth quarter 2004) and even fell slightly in March, according to preliminary figures. The major reason for the slowdown is weaker activity in the euro area, where more than half of Austrian exports go to. The recession in Italy led to a fall in demand for Austrian goods in the first quarter. Deliveries to the ten new EU member states, which take up nearly 13 percent of Austrian exports, increased by 2¼ percent year-on-year, but some losses have been recorded here as well, such as on the Hungarian market. Demand growth has remained lively only from the emerging markets in south-eastern Europe and from the oil producing countries.

Exports of motor vehicles have fared particularly badly at the beginning of the year. Having almost doubled in 2004, they fell by 10 percent from one year ago in the first quarter. With a time lag, slackening exports also weigh on industrial production. The manufacturing production index adjusted for the number of working days was still up by 5 percent from last year in the first quarter, in March by 3.3 percent. On a seasonally-adjusted basis, however, output has been falling from month to month since autumn 2004. In the regular WIFO business survey, firms have since then reported a marked fall in incoming foreign orders, although the latest data for May suggest a slight improvement. While output expectations for the next few months are stable, the assessment of the longer-term business situation is on balance unfavourable.

The business climate in the Austrian manufacturing sector weakened to a lesser extent than that in the euro area overall. The deterioration was particularly noticeable in France and Belgium. High unemployment and the squeeze in real incomes due to low wage settlements and high energy prices are undermining consumer confidence in the euro area. Because of weak consumer demand and subdued investment spending, business activity is likely to turn out sluggish in the second and third quarter. Economic policy in the EU has found no means over the last couple of years to overcome the persistent weakness of demand.

In Austria, likewise, domestic demand is showing no signs of recovery. Investment in machinery and business equipment has probably barely increased, as indicated by the results of the WIFO investment survey and the fall in imports of machines and vehicles by 7¼ percent in value in the first quarter. The negative trend of foreign trade and investment is bearing down on wholesale trade.

Retail sales have disappointed in the first quarter. They have gained only 1 percent in real terms from the year-earlier period, implying quasi-stagnation (+¼ percent) when adjusted for the calendar effect of the early Easter holidays. Private house-

hold consumption in the first quarter was only 0.7 percent higher in real terms than one year ago. Meagre wage gains and high inflation have so far neutralised the positive income effects of the tax reform. These effects may, however, become more visible in the second half of the year. Lively inflation, with a headline rate of 2.8 percent on average from January to April, is also driven by domestic factors: thus, the increase in the tobacco tax and higher co-payments in health insurance have boosted the rate by  $\frac{1}{4}$  percentage point; however, the strong increase in the rent component may turn out as having been over-stated.

Developments have been more favourable in the sectors of tourism and construction. In the 2004-05 winter season, output of the tourism industry rose by over 4 percent from the year-earlier period. While the number of overnight stays fell for customers from Austria, Germany and Switzerland, it increased markedly for visitors from the UK, Belgium and France. The building sector benefited from higher demand for housing due to strong immigration, as well as from higher demand for renovation by public authorities. Output in civil engineering is set to post only small further gains, following the substantial increase in investment in infrastructure over the last years. Despite the lively construction activity, the number of people employed in the sector keeps falling, by 3,000 year-on-year for the period from January to April.

Employment in manufacturing is also receding, by 11,500, although part of the recorded fall may be due to a re-classification in the social security statistics. Female employment is rising strongly in the service sector, with the bulk of the jobs newly created probably being part-time. In spite of the significant increase in the number of people in active dependent employment (+32,000 year-on-year in May), unemployment continues to rise markedly. Since January 2001, the jobless figure has been on an upward trend. In May, 8,000 more people than last year were registered as unemployed with the labour market service, and 9,000 more were enrolled in vocational training courses.