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# Economy Deteriorating at Accelerating Pace

## Business Cycle Report of March 2009

**Following a contraction of the Austrian economy by 0.2 percent quarter-on-quarter, seasonally and working day adjusted, in the fourth quarter of 2008 (+0.3 percent year-on-year), the slowdown in manufacturing activity continues in the first quarter of 2009. The results of the latest WIFO Business Cycle Survey signal a deepening of the crisis. The recession that has hit Austria's major trading partners is weighing on export and industrial activity, with the job market reacting with a rapid rise in unemployment in February.**

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Austria's real GDP contracted by 0.2 percent quarter-on-quarter, seasonally and working day adjusted, in the fourth quarter of 2008 (following ±0.0 percent in the third quarter), according to the latest Quarterly National Accounts. Compared with the previous year, it still advanced by 0.3 percent in real terms. Export-driven industrial activity weakened towards the end of the year, reflecting the recession that has hit Austria's major trading partners. With manufacturing output declining by 1.4 percent quarter-on-quarter, exports also fell markedly in the fourth quarter (–0.8 percent compared with the previous quarter). Evidence from WIFO's February business cycle survey indicates that the downward trend in manufacturing is continuing in the first quarter of 2009. More than 50 percent of the surveyed companies assessed their current business situation as unsatisfactory, and almost two thirds judged exports to be too small. This represents the worst assessment since spring 1996.

The impact of the crisis on the construction sector is also intensifying. With real value added having declined by 0.5 percent quarter-on-quarter in the fourth quarter, firms in February continued to assess both construction activity in the past three months as well as current order book levels as weak. However, firms had given an even more negative assessment in the last downturn from 2001 till 2003.

Household spending remained stable in the fourth quarter; it generally shows less cyclical fluctuation than exports and manufacturing output. Private consumption, at +0.2 percent in real terms quarter-on-quarter, expanded at a similar pace as in the preceding quarters. Value added in the trade sector declined by 0.5 percent in seasonally adjusted terms, with notably wholesalers and automobile traders registering weak business. Tourism, which reacts with a lag to global demand changes, continued to provide a stimulus.

The three largest economic regions – USA, Japan and EU – are in recession. Almost all industrialised countries saw GDP shrink substantially in the fourth quarter of 2008. Leading indicators suggest the crisis in the USA may deepen further during the first quarter of 2009. According to advance estimates, industrial production in January remained 10 percent below the year-earlier level. The seasonally adjusted unemployment rate stood at 8.1 percent in February, its highest level in 25 years. Real estate markets remain weak. For the euro area, the Euroframe Growth Indicator predicts a decline in GDP by somewhat more than 2 percent year-on-year for both the first and the second quarter of 2009. The sharp drop in industrial production recorded at the end of 2008 is likely to continue at an accelerating pace: in December, new orders were down 22.3 percent compared with a year earlier.

The emerging economies of Asia are also suffering from weakening import demand in industrialised countries, growth decelerated markedly at the end of 2008. So far there have been no signs of a pick-up in global economic activity.

Table 1: Quarterly national accounts

	2007			2008				
	Third quarter	Fourth quarter	First quarter	Second quarter	Third quarter	Fourth quarter		
Percentage changes from previous quarter								
Adjusted for seasonal and working day effects, volume								
Final consumption expenditure	+ 0.6	+ 0.4	- 0.4	+ 0.7	- 0.0	+ 0.4		
Households <sup>1</sup>	+ 0.2	+ 0.4	+ 0.1	+ 0.2	+ 0.4	+ 0.2		
General government	+ 1.6	+ 0.8	- 2.3	+ 2.5	- 1.0	+ 1.0		
Cross capital formation	+ 0.7	+ 0.7	+ 0.3	+ 0.4	+ 0.2	- 0.0		
Gross fixed capital formation	+ 0.9	+ 0.7	+ 0.5	+ 0.4	+ 0.1	+ 0.1		
Machinery and equipment	+ 1.0	+ 0.6	+ 0.5	+ 0.6	+ 0.0	- 0.2		
Construction	+ 0.4	+ 0.5	+ 0.4	+ 0.1	- 0.3	- 0.4		
Exports, goods and services	+ 1.8	+ 1.3	+ 0.5	- 0.2	- 1.0	- 0.8		
Goods	+ 1.4	+ 1.6	+ 0.7	- 0.5	- 1.3	- 1.4		
Services	+ 1.8	+ 1.4	+ 0.4	+ 0.2	- 0.3	- 0.2		
Imports, goods and services	+ 1.9	+ 1.3	- 0.3	+ 0.6	- 1.1	- 0.2		
Goods	+ 1.8	+ 1.1	- 0.0	+ 1.0	- 1.7	- 0.7		
Services	+ 1.2	+ 0.7	+ 0.1	- 0.1	- 0.1	+ 0.1		
Gross domestic product	+ 0.7	+ 0.7	+ 0.5	+ 0.2	+ 0.0	- 0.2		
Manufacturing	+ 1.0	+ 1.7	+ 1.5	+ 0.0	- 0.8	- 1.4		
	2007	2008		2007		2008		
			Third quarter	Fourth quarter	First quarter	Second quarter	Third quarter	
Percentage changes from previous year								
Volume, chained prices								
Final consumption expenditure	+ 1.2	+ 0.8	+ 0.8	+ 1.4	+ 0.7	+ 0.9	+ 1.1	+ 0.4
Households <sup>1</sup>	+ 1.0	+ 0.9	+ 0.4	+ 1.0	+ 0.9	+ 0.5	+ 1.4	+ 0.7
General government	+ 1.8	+ 0.5	+ 1.9	+ 2.6	+ 0.1	+ 1.9	+ 0.2	- 0.3
Cross capital formation	+ 3.6	+ 4.8	+ 5.5	- 0.8	+ 1.1	+ 8.0	+ 2.2	+ 7.7
Gross fixed capital formation	+ 4.7	+ 1.8	+ 4.9	+ 3.1	+ 1.6	+ 5.5	+ 0.6	- 0.3
Machinery and equipment	+ 5.9	+ 1.2	+ 8.8	+ 7.9	- 1.8	+ 8.6	- 1.5	- 0.1
Construction	+ 2.8	+ 1.5	+ 1.4	- 1.2	+ 4.0	+ 2.6	+ 1.3	- 1.0
Exports, goods and services	+ 8.8	+ 2.0	+ 8.2	+ 8.5	+ 5.3	+ 5.9	+ 2.4	- 4.9
Goods	+ 9.1	+ 1.5	+ 7.7	+ 6.9	+ 4.5	+ 6.6	+ 2.9	- 7.6
Services	+ 7.9	+ 3.7	+ 9.6	+ 13.1	+ 7.3	+ 3.6	+ 1.0	+ 2.6
Imports, goods and services	+ 7.5	+ 1.6	+ 8.8	+ 6.0	+ 2.4	+ 6.8	- 0.4	- 2.1
Goods	+ 8.4	+ 1.8	+ 10.1	+ 5.8	+ 2.4	+ 7.7	- 0.5	- 2.4
Services	+ 4.0	+ 0.9	+ 4.9	+ 6.6	+ 2.3	+ 2.8	- 0.1	- 1.0
Gross domestic product	+ 3.1	+ 1.8	+ 2.7	+ 2.6	+ 2.8	+ 2.4	+ 1.6	+ 0.3
Manufacturing	+ 5.5	+ 3.5	+ 4.8	+ 4.5	+ 5.2	+ 5.6	+ 4.0	- 0.6
Gross domestic product, value	+ 5.3	+ 4.2	+ 5.0	+ 5.1	+ 5.5	+ 5.5	+ 4.5	+ 1.4

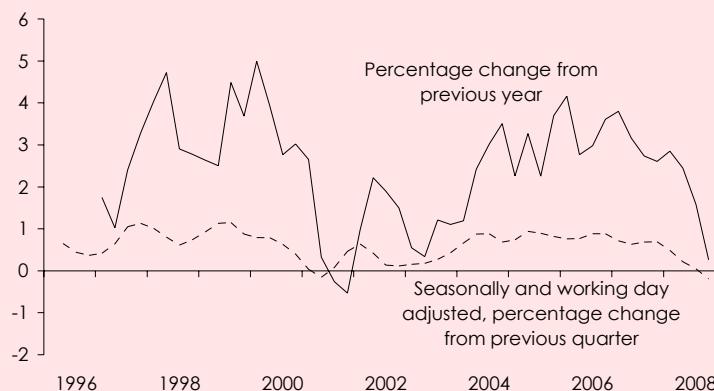
Source: WIFO. – <sup>1</sup> Including private non-profit institutions serving households.

Crude oil and other commodity prices have been steadily declining since the middle of 2008 in reaction to deteriorating demand. At the end of February, Brent crude was traded at \$ 40 per barrel. In July 2008 it had reached a peak of around \$ 140. The HWI Index of World Market Prices of Commodities, which comprises food, alcohol and tobacco as well as energy and industrial raw materials, over the past four months dropped by around 40 percent in dollar terms (cumulated), compared with the same period a year earlier. The reduction in the cost of fuel and heating oil dampened inflation in the euro area and in the entire EU. Inflation in Austria fell to 1.2 percent in January, reaching its lowest level in almost three years.

The economic downturn has now taken hold of the Austrian labour market. Following a surge in unemployment in January (+33,000 year-on-year), February saw as many as 302,000 persons registered as unemployed (+58,000, +24 percent), with the cyclically sensitive manufacturing and construction sectors particularly affected. The number of persons in dependent active employment fell for the first time since spring 2003 (-0.8 percent year-on-year).

Figure 1: Growth of real GDP

Percentage changes from previous period



Source: WIFO.

US real GDP fell at a seasonally adjusted quarterly rate of 1.6 percent in the fourth quarter of 2008 as the demand for consumer goods and equipment investment weakened further. This was the biggest contraction since the beginning of 1982. Household expenditure on consumer durables and business spending on equipment posted a particularly sharp decline (–6.1 percent and –5.7 percent, respectively). This is reflected in weakening import demand. Export activity also plunged. The only positive contribution to growth in the fourth quarter came from government spending; it has been exerting an expansionary effect already since the middle of 2008.

GDP is likely to contract further in the first quarter of 2009. Similarly to previous months, industrial production fell by 1.8 percent month-on-month or 10 percent year-on-year in January, reflecting prolonged factory shutdowns owing to the demand shortfall. Capacity utilisation in the industrial sector stood at 72 percent in January, a decline by 1.3 percentage points from a year earlier. The seasonally adjusted unemployment rate reached 8.1 percent in February, its highest level in 25 years (December 2008: 7.2 percent, January 2009: 7.6 percent). Housing market performance also remains poor. While the number of building permits granted fell once more in January (–4.8 percent month-on-month, seasonally adjusted, –50 percent year-on-year) the house price decline continued unabated, according to the S&P/Case-Shiller Index (December –18.5 percent compared with a year before).

Weak global demand for cars and electronic items weighs particularly on Asia's export-oriented economies. The Japanese economy contracted for the third consecutive time in the fourth quarter of 2008 (–3.3 percent quarter-on-quarter, seasonally adjusted); in January, the downturn in exports accelerated. The Chinese economy, which until now expanded at a rapid pace, also cannot evade the shortfall in global demand: Exports have already been falling since October 2008, with the pace of decline accelerating lately.

Seasonally adjusted GDP declined for the third consecutive time in both the euro area and the entire EU during the fourth quarter of 2008 (–1.5 percent compared with the previous quarter, –1.3 percent compared with the same quarter of the previous year). A particularly sharp drop was recorded for manufacturing value added (–5.4 percent in the euro area, –5 percent in the EU, compared with the previous quarter). Leading indicators suggest GDP will decline further in the first quarter of 2009. Consumer and business sentiment indicators continue to point markedly downwards. The Euroframe Growth Indicator predicts that GDP in the euro area will contract by somewhat more than 2 percent year-on-year in both the first and second quarters of 2009. The decline in manufacturing activity many countries posted already at the end of 2008 is likely to continue at an accelerating pace: In Decem-

## Global economic downturn continues

GDP in the USA and in Japan contracted considerably in the fourth quarter of 2008. Weak global demand faced by the car industry continues to weigh on industrial and export activity.

## EU in recession

ber 2008 compared with December 2007, industrial new orders decreased by 22.3 percent.

In East-Central Europe, the effects of the financial crisis are becoming apparent partly with a lag. While Poland and Slovakia still registered growth (in seasonally adjusted terms) during the fourth quarter, the Czech Republic and Hungary saw GDP contract compared with the previous quarter. Those currencies that are not linked to the euro have partly lost significant value in recent months.

At the beginning of March the ECB cut its key interest rate by a further 50 basis points to 1.5 percent, the lowest level seen since the Monetary Union came into force. The Bank of England follows a more expansionary stance; it cut the key interest rate to a mere 0.5 percent (down from as much as 5 percent in October 2008).

Annual inflation averaged 1.2 percent in the euro area in February, according to advance estimates by Eurostat. Owing to the decline in fuel prices it had fallen to 1.1 percent in January, its lowest level in almost ten years. Average inflation in the EU slowed to 1.7 percent in January. While Luxembourg and Portugal registered hardly any price increases compared with a year before, inflation in Latvia and Lithuania still ran at almost 10 percent.

The seasonally adjusted unemployment rate in the EU has been rising steadily already for twelve months now, reaching 7.6 percent in January. Very high increases were observed in Latvia (from 6.2 percent to 12.3 percent) and Spain (from 9.0 percent to 14.8 percent).

Following a contraction of the German economy by 0.5 percent quarter-on-quarter already in both the second and third quarters of 2008, the downward trend accelerated markedly in the fourth quarter. Real GDP declined by -2.1 percent from the previous quarter, its deepest fall on record since German reunification. Given its high dependence on exports, the German economy suffers particularly from the global downturn. Plummeting export demand in the fourth quarter (-7.3 percent quarter-on-quarter, seasonally adjusted) damped overall economic development. As at the same time imports remained only 3.6 percent below the year-earlier level, the decrease in GDP was almost entirely attributable to the contribution from net trade (-2 percentage points). This development was reflected in a fall in manufacturing output by 7.1 percent in the fourth quarter.

Industrial production is likely to decline further in the first half of 2009. The assessment of the business situation by firms in the industrial sector has been deteriorating for months, most recently also in February. The ifo Business Climate Index, which apart from the manufacturing sector also comprises the construction industry and the wholesale and retail trade, plunged to its lowest level since 1982. Following a modest 2008, the Retail Sales Index posted yet another fall in January (-1.3 percent in real terms, year-on-year).

Austria's economy contracted at a seasonally and working day adjusted quarterly rate of 0.2 percent in real terms in the fourth quarter of 2008. Compared with the previous year, real GDP still advanced by 0.3 percent. The seasonally adjusted decline in manufacturing value added observed since the third quarter of 2008 accelerated in the fourth quarter (-1.4 percent). Evidence from the WIFO business cycle survey shows that activity in the export-driven industrial sector weakened further at the beginning of 2009. In February, more than 50 percent of the companies surveyed assessed their current business situation as poor, almost two thirds judged exports to be too small. This was the worst assessment since spring 1996. Firms in the car industry and capital goods manufacturers are currently extremely pessimistic in their assessment of order books and in their expectations regarding future business conditions.

Growth in the largest economies of the EU came to a halt (in seasonally adjusted terms) already in the middle of 2008. In East-Central Europe, the repercussions of the financial crisis are becoming apparent with a lag.

## Germany: economy contracting sharply

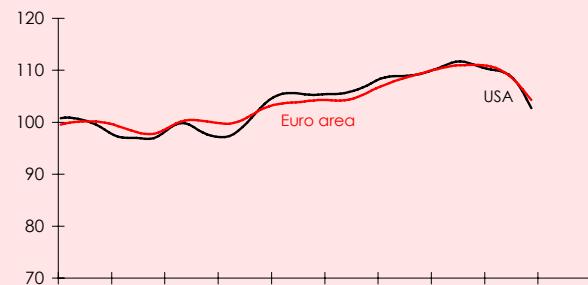
The German economy contracted by 2.1 percent (quarter-on-quarter, seasonally adjusted) in the fourth quarter of 2008, with especially export-driven industrial activity suffering from plummeting global demand.

## Downturn in export sector weakens Austrian economy

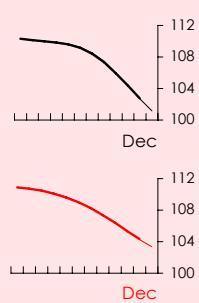
Figure 2: International business climate

Seasonally adjusted, 2000 = 100, 3-month moving average

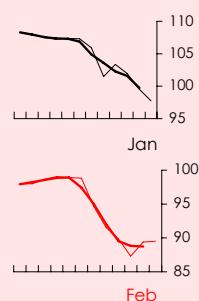
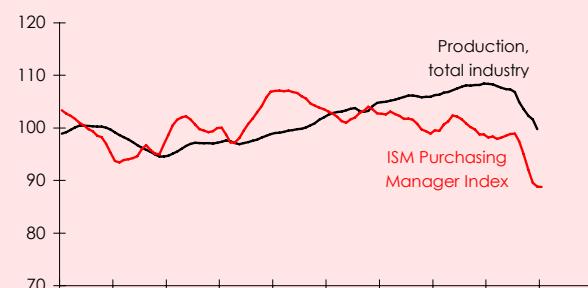
## Leading indicators



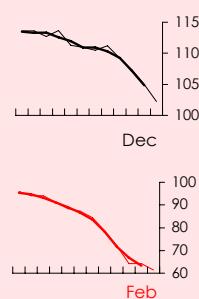
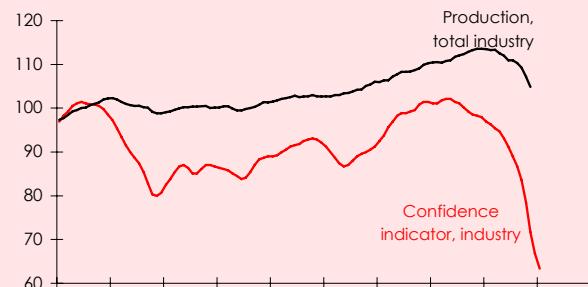
## 12-month performance



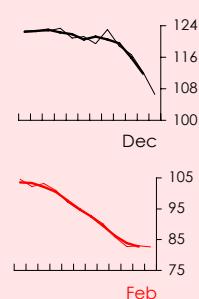
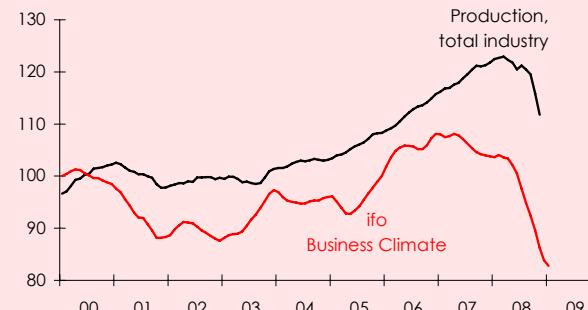
## USA



## Euro area



## Germany



Source: European Commission, Deutsche Bundesbank, ISM (Institute for Supply Management™), ifo (Institute for Economic Research, Munich), OECD.

The economic downturn across Austria's major trading partners is depressing export demand. According to the National Accounts, a quarter-on-quarter decline on a seasonally adjusted basis has been observed already since the second quarter of 2008 (real goods exports -1.4 percent in the fourth quarter). Compared with a year earlier, real goods exports fell by 7.6 percent, imports by 2.4 percent.

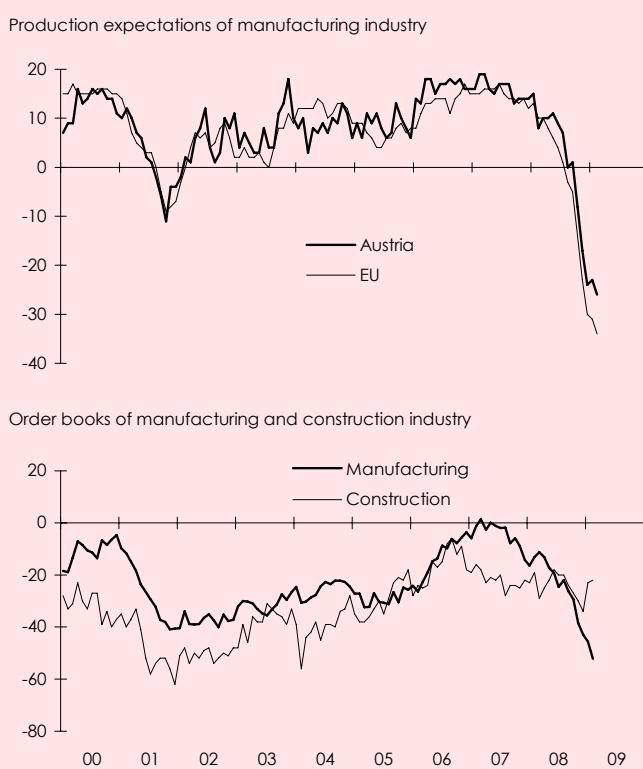
According to the Foreign Trade Statistics, 29.7 percent of exports in 2008 went to Germany, and 8.6 percent to Italy. 14.3 percent of Austrian exports went to East-Central Europe. At the end of 2008, exports remained markedly below year-earlier levels (nominal goods exports -14.1 percent in November 2008, -9 percent in December). The growth rate for 2008 as a whole was therefore only a mere 2.3 percent.

*In the course of the international economic downturn, Austria's GDP also contracted in the fourth quarter of 2008. Leading indicators signal a further slowdown in industrial activity in the first quarter of 2009.*

The repercussions of the crisis on the construction sector are intensifying appreciably. In the third quarter of 2008, value added shrank for the first time since autumn 2001 on a quarter-on-quarter basis (-0.1 percent). The decline accelerated appreciably in the fourth quarter of 2008 (-0.5 percent). Construction activity is expected to remain weak during the first quarter of 2009. In WIFO's latest business cycle survey, almost half of the firms declared order book levels to be insufficient. However, in the years 2001-2003, they had given an even worse assessment. In the course of the downturn in construction activity firms expect building prices to fall in the months to come, and intend to lay off staff.

Figure 3: WIFO Business Cycle Survey

Differences between the percentage shares of correspondents giving positive and negative replies, seasonally adjusted



Source: European Commission, WIFO Business Cycle Survey.

## Construction value added in decline

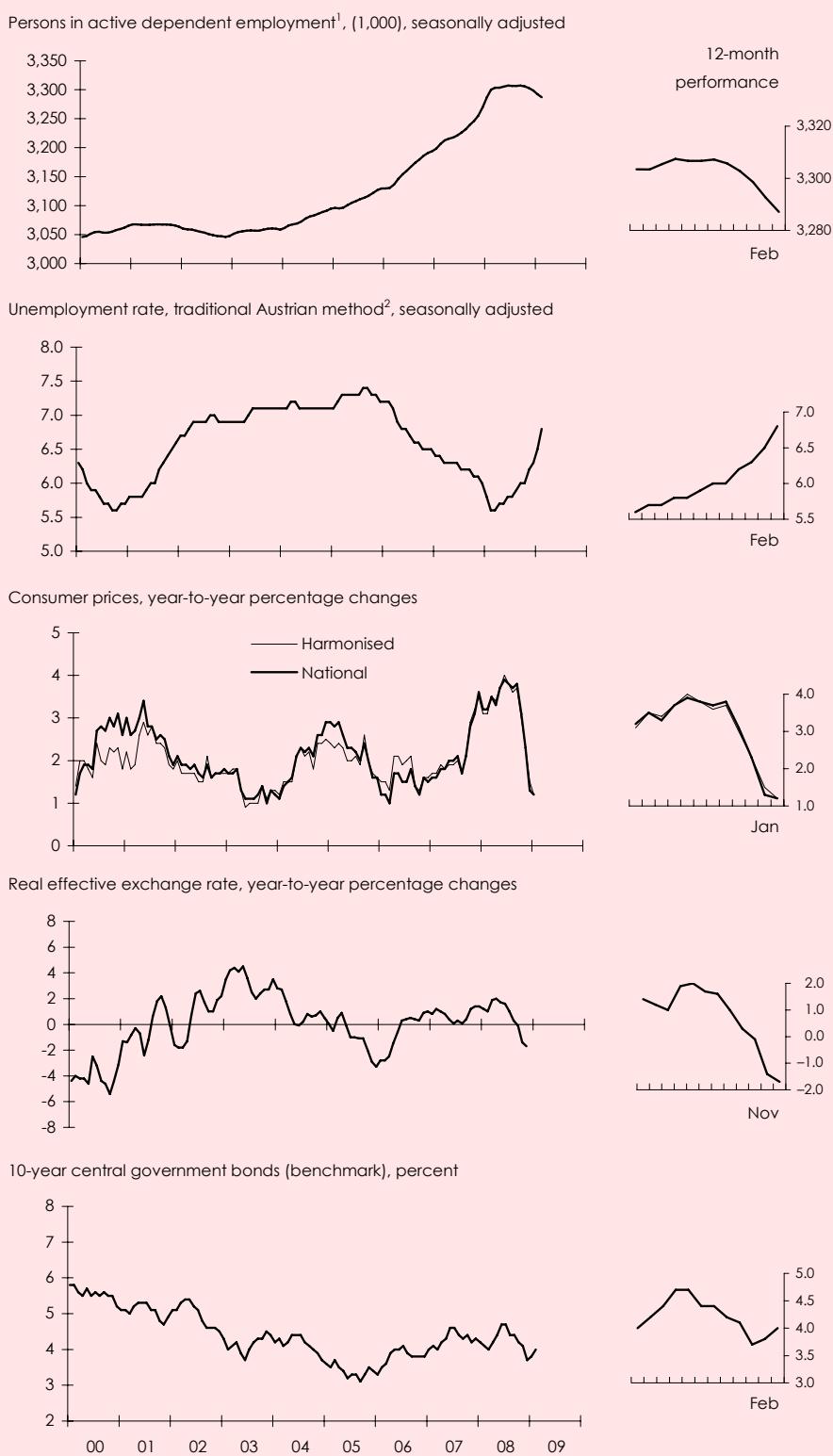
*The construction industry, a pillar of economic activity until the onset of the downturn, has seen value added decline in seasonally adjusted terms since the third quarter of 2008.*

Household spending, which generally shows less cyclical fluctuation than investment and exports and therefore has a stabilising effect, in the fourth quarter of 2008 grew hardly less than in the course of 2008 (+0.2 percent in real terms, quarter-on-quarter, +0.7 percent year-on-year). But the uncertainty among consumers is reflected in a

## Trade activity also slowing now

decline in the consumption of durable goods. This tendency is likely to persist at the beginning of 2009. In January 2009, both used and new passenger car registrations fell by around 13 percent from a year before.

Figure 4: Key economic indicators



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

While real retail sales stagnated in the fourth quarter compared with a year earlier, automobile sales have been falling already since the middle of 2008. Owing to the downturn in industrial activity, wholesale business decelerated sharply in the fourth quarter of 2008.

Although tourism in Europe has in part already been suffering sizeable losses since autumn 2008, Austria's tourism industry, as expected, has still been registering a strong increase in demand in the winter season so far (partly also due to calendar effects) owing to its competitive advantages in winter sports: According to preliminary estimates, Austrian tourism sales rose by 4.9 percent in real terms in the first half of the 2008-09 winter season. The slowdown in global demand is expected to spread to tourist travel in Austria as from late winter 2009. So far the economic and financial crisis appears to have had hardly any negative effect on city tourism. Between November 2008 and January 2009, the number of overnight stays increased by 4.9 percent, with the demand from foreign guests rising more strongly (+5.1 percent) than that from resident travellers (+4.2 percent).

Demand trends in the major markets of origin of Austria's tourism industry varied considerably in the first three months of the 2008-09 winter season: Especially the number of overnight stays by guests from Poland and the Czech Republic rose briskly (+46.8 percent and +34.4 percent, respectively), whereas the number of nights spent by guests from Great Britain and the USA declined (-7.0 percent and -18.1 percent, respectively); in these markets, the financial and economic crisis already appears to dampen the readiness to travel.

Inflation in Austria has been easing steadily since the middle of 2008. In January 2009 the inflation rate stood at 1.2 percent (December 2008 1.3 percent, November 2.3 percent), its lowest level since autumn 2006. This development was due mainly to the fall in fuel and heating oil prices (inflation rate excluding energy 2.3 percent). Around one third of headline inflation can nevertheless be attributed to the expenditure category "Housing, Water, Energy" (especially housing maintenance). The gas price, which follows crude oil price developments with a lag of around six months, at +18 percent registered extremely brisk growth in January.

Following the boom in mid-2008, crude oil and other commodity prices have been steadily falling amid weakening global demand. At the end of February, Brent crude traded at \$ 40 per barrel, down from a peak of around \$ 140 in July. The HWWI Index of World Market Prices of Commodities, which comprises food, alcohol and tobacco as well as energy and industrial raw materials, over the past four months dropped by around a cumulative 40 percent in dollar terms, compared with the same period a year earlier. The prices of industrial goods (except energy) are also considered cyclically sensitive and are falling in reaction to the economic downturn.

The full force of the economic downturn is now hitting the Austrian labour market. Following a surge in unemployment in January (+33,000 year-on-year), the situation quickly deteriorated further in February. 302,000 persons were registered as unemployed, an increase by 58,000 or 24 percent from a year earlier. The 58,000 persons who were enrolled in vocational training programmes were not counted as unemployed. Unemployment rose especially in the cyclically sensitive manufacturing and construction sectors – despite the expansion of short time working. Those first affected in these sectors are loaned workers and young people who have not yet gained a foothold in the job market. Some job losses in the construction industry in February may also have been weather-related. Following sharp employment gains over the past business cycle, the number of persons in dependent active employment fell for the first time since spring 2003 (-24,500, -0.8 percent, year-on-year).

The rise in unemployment was apparent in the seasonally adjusted data already since spring 2008. In February 2009, the increase accelerated considerably (+3.6 percent month-on-month). The seasonally adjusted unemployment rate stood at 6.8 percent in February, according to the definition by the Public Employment Service (AMS), and at 4.0 percent in January, according to the Eurostat definition.

## Winter tourism sees demand strengthened due to competitive advantages

*Tourism reacts with a lag to the slowdown in global demand. Sales still increased considerably in the first half of the winter season.*

## Inflation easing further

*Inflation fell to 1.2 percent in January. Fuel and heating oil prices were markedly lower than a year before.*

## Rise in unemployment accelerating

*While unemployment rose markedly in February 2009, the number of persons in active employment fell for the first time since spring 2003. The cyclically sensitive manufacturing and construction sectors are particularly affected.*