

Christian Glocker

Domestic Activity Bolsters Economic Growth in Austria

Business Cycle Report of August 2016

Domestic Activity Bolsters Economic Growth in Austria. Business Cycle Report of August 2016

According to WIFO's latest Flash Estimate, Austrian real gross domestic product grew by 0.3 percent quarter on quarter in the second quarter of 2016 (trend-cycle component). Hence the underlying momentum of economic activity in Austria showed a similar upward trend as in previous quarters. Growth was largely driven by domestic demand, while net trade provided hardly any stimulus. The picture painted by leading indicators keeps improving, but the general sentiment remains subdued.

Contact:

Christian Glocker: WIFO, 1030 Vienna, Arsenal, Objekt 20, Christian.Glocker@wifo.ac.at

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: 6 June 2016.

Data processing: Astrid Czaloun (Astrid.Czaloun@wifo.ac.at), Christine Kaufmann (Christine.Kaufmann@wifo.ac.at), Maria Riegler (Maria.Riegler@wifo.ac.at), Martha Steiner (Martha.Steiner@wifo.ac.at)

ISSN 1605-4709 • © Austrian Institute of Economic Research 2016

Impressum: Herausgeber: Karl Aiginger • 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 did gain some momentum in spring, but its pace remains moderate. In emerging market economies, activity appears to have bottomed out, following a marked slowdown over the course of 2015. Meanwhile, there is increased evidence of a pick-up in growth in China and an easing of the recessions in Russia and Brazil. Among advanced economies, the expansion remained subdued notably in the USA in the first half of 2016, while it was considerably brisker in the euro area. Global economic growth is expected to pick up gradually in the coming months, driven by the persistently robust performance in major advanced economies and the easing of the deep recessions underway in several big emerging market economies. However, the outlook remains surrounded by major downward risks, notably in emerging market economies.

In Austria, growth accelerated also in the first half of 2016. The buoyant forces are robust and are founded on domestic activity. The underlying trend of economic activity points upward. In recent months the expansion in Austria has once again been driven mainly by growing consumption and investment demand. Household consumption rose by 0.3 percent, quarter on quarter, in both the first and the second quarter. Special effects such as the tax reform implemented at the start of the year as well as savings owing to persistently low energy prices are assumed to have increased the propensity to consume. Government consumption also continued to grow noticeably (second quarter +0.2 percent). Moreover, domestic businesses have again been increasing their investment spending since 2015; for instance, gross fixed capital formation, which also comprises machinery and equipment and construction investment, at +0.8 percent continued to grow markedly in the second

quarter. Hence the recovery following the sharp fall in 2014 continued. Net trade once again did not contribute to economic growth.

Inflation dynamics have remained unchanged lately. The CPI rose by 0.6 percent year on year in June 2016 (in May also +0.6 percent). Inflation as measured by the Harmonised Index of Consumer Prices was also +0.6 percent, thus remaining well above the euro area average (+0.1 percent). Employment grew further in July, with the number of persons in dependent active employment rising by 3,300 on a seasonally adjusted basis, compared with the previous month. Compared with a year before, employment increased by 47,000 or 1.3 percent. The unemployment rate stood at 9.2 percent in July (seasonally adjusted).

1. Global economic growth remains sluggish

While global economic activity did gain some momentum in spring, its pace remains moderate. Indicators have stabilised and, overall, point to persistently steady economic developments. The pick-up in commodity prices, which have clearly risen above the trough reached in January, is one of the factors indicating an acceleration of global economic activity in recent months. Meanwhile, the sentiment in financial markets has brightened. However, more restrictive financing conditions, which are in part related to the normalisation of monetary policy in the USA, continue to restrain the international environment, notably in emerging market economies. Risks are also posed by the gradual reorientation of the Chinese economy and geopolitical developments, for instance the outcome of the UK referendum in favour of leaving the EU. Hence the outlook for the global economy and notably for emerging market economies remains surrounded by major downward risks.

1.1 Downward risks remain high in emerging market economies

Activity appears to have bottomed out in emerging market economies. Notably 2015 was marked by a considerable slowdown. While the recessions in Russia and Brazil intensified further, numerous indicators pointed to a substantial deceleration of the expansion in China. Against the backdrop of the steep losses suffered by stock markets, this added fuel to the worry that the Chinese economy might get caught in a critical downward spiral. At the start of 2016, disappointing economic indicators and further turmoil in financial markets in China once again fostered worries about the outlook for the Chinese as well as the global economy. Meanwhile, however, a growing amount of evidence points to a more dynamic expansion in China, supported by stronger monetary and fiscal policy stimulus measures, among other things. These economic policy measures should drive economic activity in the near term. In the medium term, however, the pace of the expansion is set to slow owing to the increased reduction of excess capacity in some heavy industry branches and the handling of loan losses resulting from it.

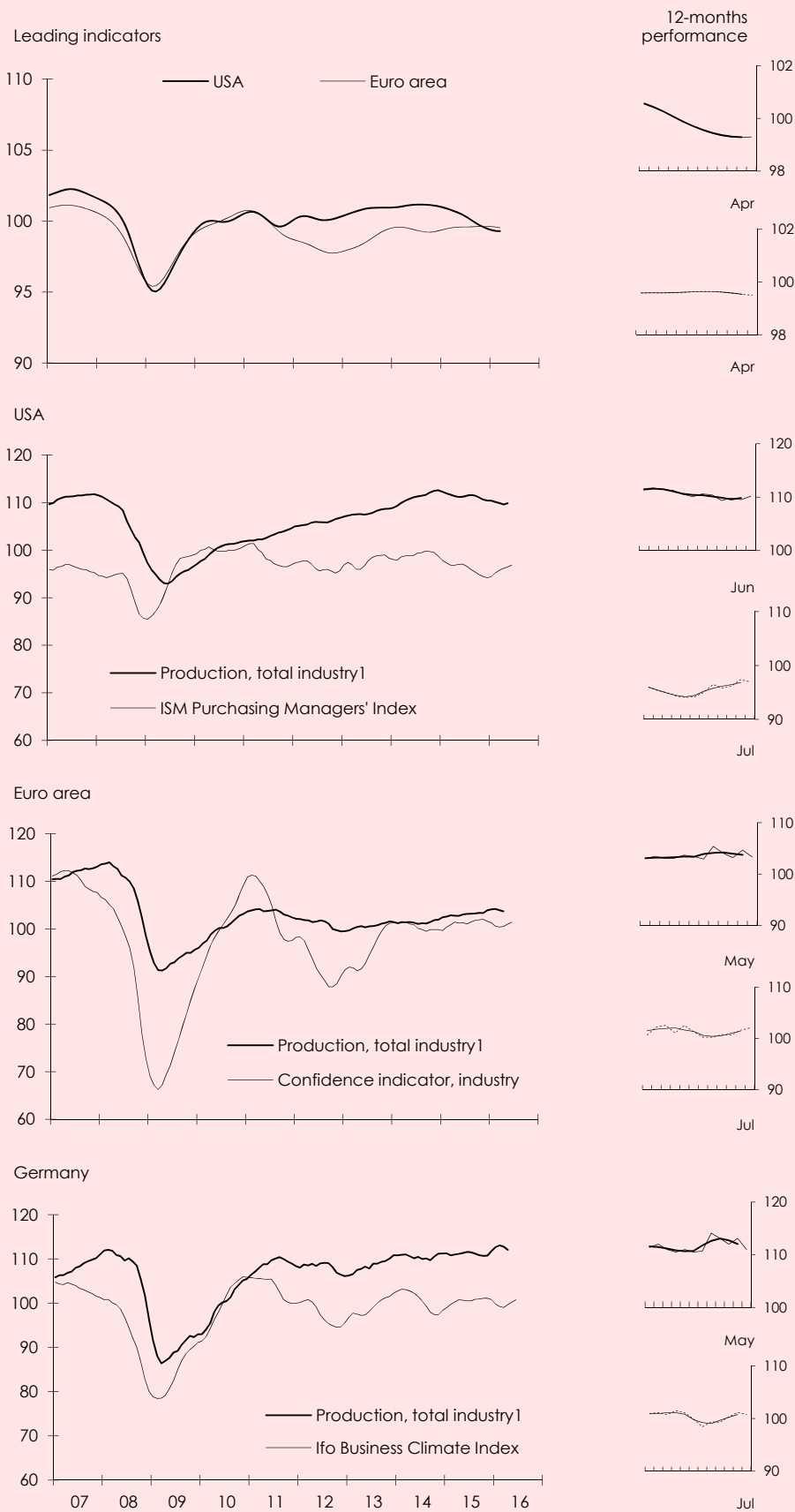
In India, the already vigorous expansion accelerated further, according to official information, while at the same time the economies in the other Asian emerging market countries expanded at a broadly unchanged, however rather modest pace for the region.

In Russia and Brazil, where deep recessions are underway, gross domestic product did contract further in the first quarter of 2016, albeit at a far slower pace. The brightening of sentiment in these countries is apparent also in financial markets; the external values of their currencies and stock prices have risen considerably since the beginning of 2016. This development was supported by the pick-up in commodity prices during the first six months of the year. Russia is expected to register slight growth during the second half of 2016. In Brazil, political uncertainty, the deterioration in the terms of trade, the tightening of monetary policy and the more restrictive financing conditions act as a considerable drag on economic activity. Going forward, the economy is expected to recover somewhat from the deep recession as commodity prices stabilise and investment in commodity sectors will no longer be affected that severely.

The global economy has been growing at a modest pace since the end of 2015. The prospects are favourable, global activity is expected to pick up. In advanced economies, it is supported by persistently low interest rates, improvements in labour market conditions and growing confidence. By contrast, the outlook in emerging market economies remains surrounded by greater uncertainty: on the one hand, the reorientation of the Chinese economy is associated with major risks, while on the other hand, the economies in commodity-exporting countries are adjusting to the relatively low commodity prices. Last but not least, the economic prospects are dampened by political tension in the Middle East.

Figure 1: International business climate

Seasonally adjusted, 2010 = 100, 3-month moving average



Source: European Commission, Deutsche Bundesbank, ISM (Institute for Supply ManagementTM), Ifo (Institute for Economic Research, Munich), OECD. - ¹ Excluding construction.

1.2 Expansionary monetary policy supports economic activity in advanced economies

Advanced economies witnessed continued moderate economic growth overall in the first quarter of 2016, however with highly heterogeneous patterns across countries: while in the USA the expansion remained weak compared with the previous quarter, it picked up in the euro area and in Japan. But in the euro countries this may have been partly due to transitory effects such as the mild winter weather so that the GDP growth rate of 0.6 percent may well slightly overdraw the underlying trend of economic activity. GDP grew at a slightly slower pace in the second quarter (+0.3 percent) according to the latest flash estimates.

In the USA, economic activity slowed already in the fourth quarter of 2015. On the one hand, the slowdown was driven by the decline in business investment attributable in particular to spending cuts in the mineral oil industry. On the other hand, private consumption increased at a slower pace, despite substantial real income growth; the household saving ratio rose as a consequence. In the second quarter, economic growth remained modest at +0.3 percent, compared with the previous quarter. The slight acceleration was a result of an increase in private consumption expenditure and a pick-up in exports accompanied by a decline in imports. Private investment continued to act as a drag on GDP growth, with fixed investment once again contributing negatively to growth in the second quarter. Apart from private investment, the decline in government spending and significant stock reductions also dampened GDP growth. The latest economic data do not paint a clear picture. The most recent flattening in employment growth suggests that the underlying trend of economic activity may have weakened somewhat.

In the UK, the stable development witnessed in previous years continued in the second quarter. Following real GDP growth of 0.4 percent, quarter on quarter, in the first quarter, the expansion accelerated to 0.6 percent in the second quarter, driven by the manufacturing and services sectors. Recently, the picture painted by leading indicators has darkened. This may well be also a consequence of the referendum outcome in favour of leaving the EU. The repercussions the vote had on financial markets were largely in line with expectations. The British currency depreciated, and the prices of bank stocks and property funds fell as well. The adjustments of government bond ratings were also foreseeable. The volatility of the Euro Stoxx 50 had increased already in the run-up to the referendum, remaining, however, within its range during the market tensions witnessed at the start of 2016 and in August 2015. Stock prices did drop noticeably on the day following the referendum, but largely stabilised again quickly. However, bank stocks continue to be rated much lower than non-bank stocks – not only in the UK, but also in the euro area. This fact points to other, more deeply rooted structural problems in the European financial sector. The latest stress test of 51 financial institutions conducted by the European Banking Authority (EBA) largely confirms these concerns. Overall, the banks tested proved considerably more stable than in the 2014 stress test, however; they have substantially increased their equity since then. But in case of a crisis not only banks from Spain, Italy or Ireland would increasingly face problems, but also institutions in Germany, the Netherlands, Austria and the UK.

1.3 Domestic demand driving economic activity in East Central Europe

Economic activity in East Central Europe remains robust, although with divergence across countries. Real economic activity in this region continues to be driven mainly by rising household consumption, which in turn is the result of real disposable income growth amid currently low and in part negative inflation rates. On the other hand, a vigorous increase in investment, which is supported by the allocation of funds from the EU Structural Fund, should be conducive to growth over the remainder of the year.

2. Growth of Austrian economy continued also in the first half of 2016

Austria's GDP expanded also in the first half of 2016. In the first quarter of 2016, growth came in at 0.4 percent. At +0.3, the underlying upward momentum continued in the second quarter. As the pace of expansion in the first quarter had been overdrawn by special effects such as the mild weather and additional expenditure for the care of refugees, the slight moderation in the second quarter had been expected. Later in the year growth rates similar to those recorded in the second quarter are likely. The buoyant forces are robust and are founded on domestic activity. The underlying trend of economic activity points upward.

In recent months, economic activity in Austria has once again been driven mainly by growing consumption and investment demand. Household consumption rose by 0.3 percent, quarter on quarter, in both the first and the second quarter. Special effects such as the tax reform implemented at the beginning of the year as well as savings owing to continued low energy prices are assumed to have increased the propensity to consume. Government consumption also continued to grow noticeably.

Moreover, domestic businesses have again been increasing their investment spending since 2015; for instance, the demand for gross fixed capital formation, which comprises machinery and equipment and construction investment, at +0.8 percent continued to grow markedly in the second quarter. Hence the recovery following the sharp fall in 2014 continued.

Mirroring the weaker growth in exports, the pick-up in export-driven industrial activity slackened somewhat at the beginning of the year, although external trade has regained some momentum recently. Both imports and exports increased; hence, overall, external trade did not contribute to GDP growth. The expansion in the manufacturing sector slowed to 0.5 percent in the second quarter (first quarter +0.7 percent). Following a weak performance in the two previous years, construction, by contrast, experienced positive impulses, with value added growth coming in at 0.5 percent in the second quarter. Market services also contributed positively to economic growth. Value added increased by 0.5 percent in wholesale and retail trade, and by 0.4 percent in the accommodation and food services sector.

2.1 Leading Indicators Improving Since Start of the Year

The results of the WIFO Business Cycle Survey show a slight month-on-month improvement overall in Austrian businesses' assessments of economic conditions. The index for the economy as a whole of firms' assessments of the current situation increased to 3.2 points in July. Sentiment improved in construction and manufacturing, while assessments by firms in the services sector deteriorated somewhat. Assessments of the business outlook continued their slight upward trend in July. The business expectations index increased and is now clearly in positive territory. Overall, the results suggest that Austrian firms' business expectations have become cautiously more optimistic. In the manufacturing industries, the expectations index improved in July and for the first time since January 2016 re-entered positive territory. The index also picked up and was clearly in optimistic territory in the services sectors. By contrast, the index for the construction sector, as in the previous month indicated a slight deterioration in business expectations and scored below average.

The Bank Austria Purchasing Managers' Index no longer reached the previous month's five-year peak in July, but at 53.4 points and with the second-highest reading in the last 2½ years signalled a continued solid growth perspective for the Austrian industry. Survey evidence shows that the slight flattening of industrial activity is broad-based. In July, almost all sub-components of the index pointed to a slightly weaker upward trend than the one seen in the previous month. The trend was determined by a weakening in production growth, demand momentum, incoming orders and purchase quantities as well as by increasingly more unfavourable price developments. The latter dragged down domestic companies' earnings for the third consecutive month. The labour force, on the other hand, grew at a brisker pace in July.

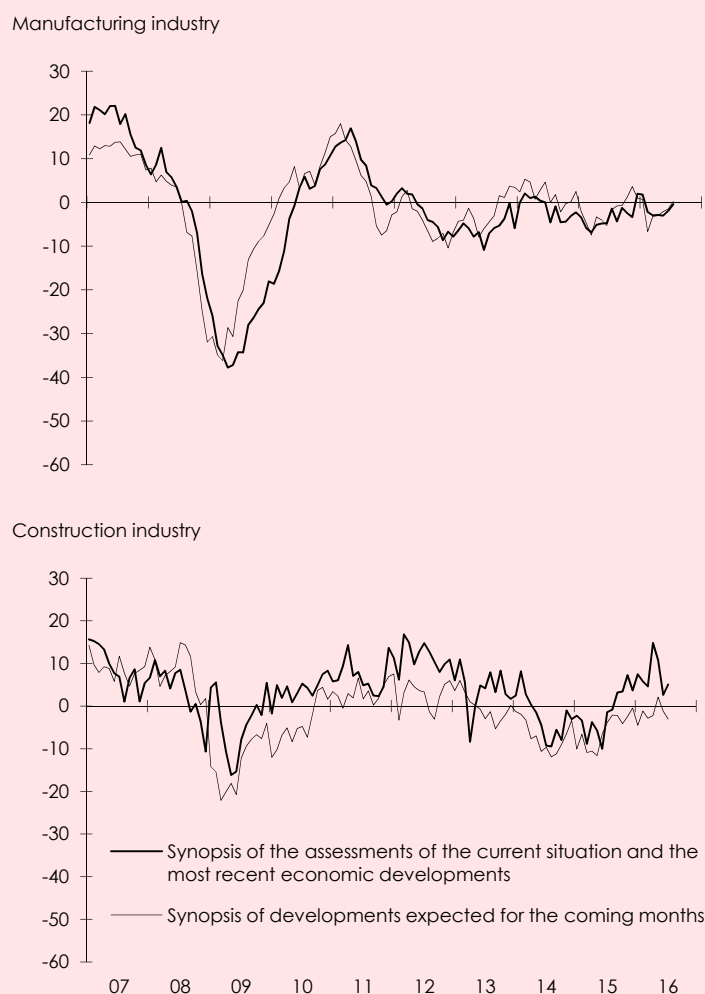
Following modest growth in previous years, economic activity accelerated in Austria during 2015. This trend continued in the first half of 2016. The expansion was largely driven by domestic demand: both consumption and investment increased further. Net trade, by contrast, did not contribute to GDP growth.

While the picture painted by leading indicators keeps improving, business sentiment in Austria varies greatly across sectors.

WIFO's Leading Indicator rose further on a month-on-month basis in July 2016. Hence the upward movement seen in previous months continued, albeit at a slower pace; the indicator reached approximately the level recorded in November 2015. Developments of the sub-components were highly heterogeneous; notably those for the retail trade and for the labour market (job vacancies) considerably determined the upward movement of the leading indicator, while those for construction and industrial production dampened its rise.

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.

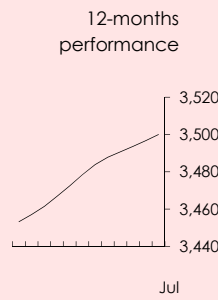
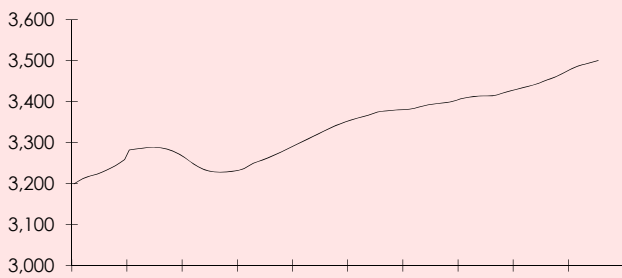
2.2 Tourism sales developing favourably

In the first two months of the 2016 summer season, Austrian tourism revenue rose by 1.4 percent compared with the same period a year before; adjusted for price changes, the increase was 0.8 percent. The "real expenditure per night spent" quality indicator remained broadly stable. The number of nights spent was up by 0.9 percent from a year before. While the demand from abroad stagnated (approximately 64 percent of the total number of nights spent), the number of nights resident travellers spent in Austria rose by 2.7 percent compared with a year before.

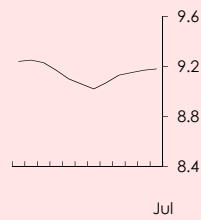
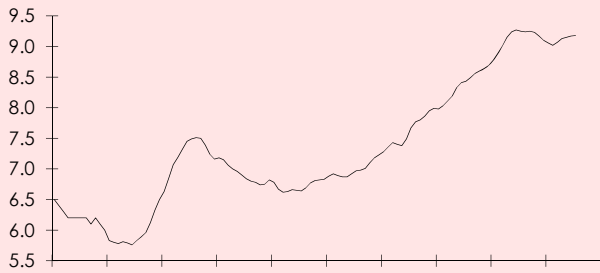
Holiday apartments as well as 1 and 2-star hotels registered an above-average increase in the number of nights spent at the start of the summer season. High-category hotels, by contrast, recorded hardly any change in the demand for overnight stays; private accommodations once again suffered a decline in demand.

Figure 3: Key economic indicators

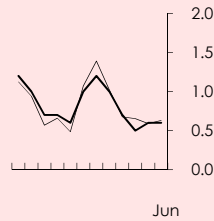
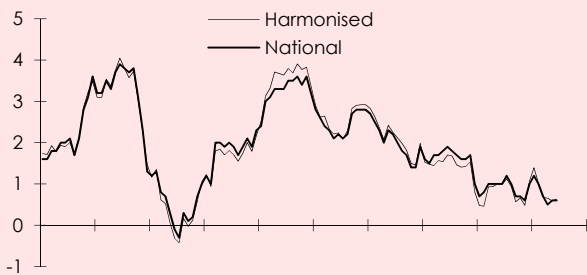
Persons in active dependent employment¹, (1,000), seasonally adjusted



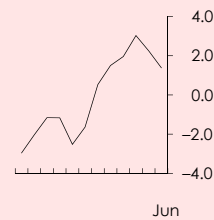
Unemployment rate, traditional Austrian method², seasonally adjusted



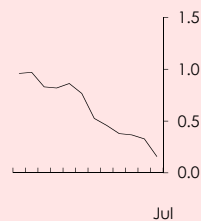
Consumer prices, year-to-year percentage changes



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 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.

Burgenland and Salzburg recorded the biggest sales increases. The results in Vorarlberg and Vienna also exceeded the Austrian average of +1.4 percent, while Tyrol and Styria posted only small gains. The other federal countries experienced a decline in tourism revenue.

Foreign demand developments in May and June 2016 varied greatly across the countries of origin: the highest increases in the number of nights spent were recorded for guests from East Central Europe (Poland +5.7 percent, Hungary +3.7 percent, the Czech Republic +3.4 percent). Apart from the Scandinavian countries Denmark (+2.3 percent) and Sweden (+1.4 percent), Germany (+2.0 percent) and Switzerland (+1.2 percent), the most important countries of origin during that period, also witnessed a sharp increase in demand. Nights spent by guests from Romania (+1.1 percent) and the UK (+1.0 percent) also exceeded year-earlier levels, while those by travellers from the Netherlands (-0.4 percent), Belgium (-1.4 percent) and the USA (-2.3 percent) declined. A marked drop compared with a year before was registered in the demand from France (-7.4 percent), Italy (-12.0 percent) and once again Russia (-21.7 percent).

2.3 Inflation rate remains considerably above euro area average

The inflation rate based on the CPI was +0.6 percent in Austria in June (in May also +0.6 percent), compared with a year before. A major upward impact to inflation came from the "restaurants and hotels" expenditure category (+3.4 percent), largely owing to price increases in catering services. Prices in the "housing, water, energy" expenditure category rose by 0.6 percent on average. The decline in liquid fuel prices (June -16.3 percent, May -20.6 percent) once again dominated price developments for household energy overall (-2.4 percent).

Prices in the "transport" expenditure category fell below their year-earlier level (-2.7 percent), notably as a result of the renewed decline in fuel prices (-10.1 percent), which was, however, smaller than the drop seen in May (-11.8 percent).

The harmonised inflation rate based on the HICP, at +0.6 percent in June equalled the rate based on the CPI. Hence inflation in Austria remained considerably above the euro area average (+0.1 percent). In June, only Belgium (+1.8 percent), Malta (+1.0 percent) and Portugal (+0.7 percent) registered higher inflation rates than Austria.

2.4 Labour market developments marked by brisk increase in labour supply

Employment growth continued in July, with the number of persons in dependent active employment rising by 3,300 compared with a month before (seasonally adjusted), and by 47,000 or 1.3 percent, compared with a year before. Following a decline in June, the number of persons unemployed (excluding persons undergoing training) rose again marginally from a year earlier (June -200, July +1,400, year on year). The last recorded seasonally adjusted figure of persons registered as unemployed was 362,300, an increase of 0.2 percent compared with a month before. In July, the seasonally adjusted unemployment rate was 9.2 percent.

The leading indicators for the labour market point to a continued favourable development of the demand for labour. The labour requirements of firms in the industrial sector, for instance, might rise further in the months ahead. This is suggested by the high level of the sub-index for employment of the Bank Austria Purchasing Managers' Index. The number of job vacancies registered with the Public Employment Service (AMS) is also on the rise, owing to the pick-up in economic activity. But as the brisk increase in labour supply continues unabated, the slightly more favourable economic development is not yet reflected in a sustained decline in unemployment.

The services sector continues to contribute strongly to inflation. The inflation rate in Austria was again considerably higher than the euro area average.

The Austrian labour market has recently continued the trend observed in previous months: both employment and unemployment continue to grow.