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SHARP SLOWDOWN IN U.S. GROWTH CASTING SHADOW ON DOMESTIC BUSINESS CYCLE

Booming exports and strong manufacturing output were the main features of Austrian business activity towards the end of 2000. Household real disposable income and retail sales, however, recorded only modest gains after mid-year. The swift downturn in the U.S. cycle is of limited immediate impact on demand and output in Europe, although private confidence has started weakening.

At the turn of the year, the Austrian business cycle is fundamentally robust. Foreign demand and industrial production have been the driving forces of expansion. Recent data on foreign trade only available up to last autumn show a year-on-year increase in nominal exports of 12 percent for the third quarter, and of 15 percent for October. Manufacturing output has slackened only slightly from its peak in summer 2000. While in the regular WIFO business survey, manufacturers of basic goods and of technical equipment have turned more sceptical in their judgement on the current business situation and capacity utilisation than three months ago, firms are still generally optimistic as to their near-term output prospects. The overhang of respondents expecting to increase production over those stating the opposite, was 12 percentage points, 4 points less than in the second quarter, but on a par with fourth quarter results.

Less favourable than industrial activity, heavily supported by foreign trade, has been the performance of sectors depending more on domestic demand. Retail sales were sluggish in the third quarter and, in October, dropped by an inflation-adjusted 1 percent below the year-earlier level. This has been due to real disposable income being squeezed by higher energy costs and higher indirect taxes and other public charges. The consumer price index rose by 2.8 percent year-on-year in the second half of 2000, gross earning increased notably, net earnings somewhat less. Construction output is still depressed by demand for new homes being saturated, weighing more heavily than the lively commercial building activity. Employment growth in the economy as a whole has decelerated markedly since last summer.

All staff members of the Austrian Institute of Economic Research contribute to the Business Cycle Report.

A crucial determinant for the further course of the business cycle is the external economic environment. Activity in the USA has slackened markedly in the fourth quarter 2000. Real GDP advanced at a mere 1.4 percent seasonally-adjusted annual rate, supported by higher private consumption and public expenditure, while equipment investment and industrial production were receding. In January, also consumer confidence dropped sharply. This suggests a further weakening of GDP growth in the current quarter. Monetary policy reacted quickly to the danger of recession, by cutting interest rates by ½ percentage point. While this move should help stabilise confidence, it is unlikely to stimulate demand in the very short term.

In the past, developments in the USA have been of great influence for the European business cycle. On the one hand, via domestic demand in North America and its impact on European exports; on the other, via capital flows and their effect on exchange rates and investment.

So far, the slowdown in the USA has had few repercussions on demand and output in Europe. GDP in the euro area has grown by 3 percent in volume in the fourth quarter 2000, according to estimates by the Euroframe group. However, business sentiment has weakened significantly in January, while consumer confidence has recovered in December with the fall in oil prices. For the first quarter 2001, leading indicators suggest a deceleration of growth to a rate of 2.6 percent.

In Germany, manufacturing orders and production were clearly heading downward in autumn, as was the ifo Institute's business climate index. More recently, business confidence declined also in other export-oriented EU countries, such as the Netherlands, Sweden and Finland, according to the regular survey conducted by the European Commission. As the ECB has so far not reacted to the deterioration of global economic conditions, the interest rate gap between the USA and Europe has narrowed considerably at the short end. Within Europe, short- and long-term interest rates have converged to a high degree.

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