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Growing Amount of Evidence Points to Slowing Economic Activity in Austria

Business Cycle Report of March 2016

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The weaker global environment is dampening economic activity in Austria; export dynamics lost vigour in the fourth quarter of 2015. By contrast, firms' willingness to invest remained robust. Expenditure for refugees' basic care was reflected in an increase in consumer spending. WIFO's Business Cycle Survey shows a worsening of companies' assessments. Hence GDP growth is likely to remain subdued also in the coming months.

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Economic activity in Austria so far has maintained its subdued but steady upward trajectory. Gross domestic product grew by 0.3 percent, quarter on quarter, in the fourth quarter of 2015, the same rate as in the two previous quarters. However, there is increased evidence that activity may be slowing.

The expansion of the global economy lost traction towards the end of 2015. Economic activity moderated notably in the USA and in Asia's emerging market economies. This becomes noticeable even more strongly as economic activity in the euro area remains lacklustre and many export-oriented emerging market economies are suffering from low commodity prices.

In the fourth quarter of 2015, these developments were already reflected in slowing growth of Austrian exports. Exports to the USA, by now Austria's second most important trading partner, expanded vigorously in 2015, but lost considerable traction in the course of the year. Growth of exports to Germany, by contrast, remained relatively robust. Investment maintained momentum until the end of the year, despite a weakening of the international environment: in the fourth quarter, gross fixed capital formation increased at about the same quarter-on-quarter pace as in the previous two quarters. This increase was driven in particular by the demand for plant and equipment; construction investment, by contrast, stagnated.

Consumption expenditure grew slightly more briskly in the fourth quarter than in the first nine months of the year, owing to increased consumption by private non-profit organisations and the government resulting from expenditure for the basic care of refugees, whose numbers had risen markedly since the summer. By contrast, growth of private consumption in the narrower sense of the word remained weak, despite

low energy prices and the fact that positive income effects from the tax reform came to bear from the beginning of January 2016 onwards.

Tourism exports declined in the fourth quarter compared with the previous quarter, owing to the extraordinarily warm start of the winter and the lack of snow in the first half of the season. With the snowfalls in January, however, the number of overnight stays in the Alpine regions increased markedly. Länder with tourism offers other than winter sports even benefitted from the mild weather in the mountains and were relatively successful particularly in the first third of the season.

The situation in the Austrian labour market remains difficult, given the lacklustre economic activity. While according to preliminary estimates the number of persons in dependent active employment rose markedly in February 2016 compared with a year before, and job vacancies also increased considerably, the number of persons registered as unemployed with Public Employment Service Austria (AMS) also increased. As already in previous months, unemployment did not rise further on a seasonally adjusted basis, however; the unemployment rate remained unchanged at 9.0 percent.

Compared with December, inflation picked up slightly again in January; compared with a year before, consumer prices were up 1.2 percent. As already in previous months, downward pressures on prices came from the sharp fall in crude oil prices, which resulted in price declines for heating oil and fuels. Price boosters were once again hotel and restaurant services, clothing, insurance services and rents. In January, the Harmonised Index of Consumer Prices (HICP) exceeded its year-earlier reading by 1.4 percent.

The outlook for the Austrian economy remains muted. WIFO's Business Cycle Survey of February 2016 shows a further deterioration in the assessments given by companies. Both the present situation and expectations for the coming months were assessed less favourably in February than a month earlier and on average over the long term. However, both indices remain in positive territory. Thus companies still assess the overall economic environment largely favourably, but no longer as representing the normal situation. The weaker international environment is reflected in particular in the assessments given by firms in manufacturing. Assessments by companies in the construction and services sectors were somewhat more positive than those given in manufacturing. WIFO's Leading Indicator in the most recent analysis also fell more markedly than previously and now lies at a similar level as in March 2015.

1. Global economy losing traction

Global economic growth lost traction in the final months of 2015. According to Centraal Planbureau (CPB), global trade expanded at a considerably slower pace in November and December than in the preceding months (three-month moving average in December +0.7 percent, compared with the previous period). Economic activity slowed notably in the USA and in Asia's emerging market economies.

The weakness of the global economy also became apparent in the commodity markets, where prices have been following a downward trend since the end of 2014. Hence the crude oil price is likely reacting also to the expansion of supplies by the OPEC countries. However, signs of stabilisation have emerged recently: at the end of February, Brent crude oil traded at 35 \$ per barrel, following a temporary price decline to 26 \$ in January. The HWWI index for industrial commodities also rose slightly on a month-on-month basis in February. Food commodity prices, by contrast, fell further.

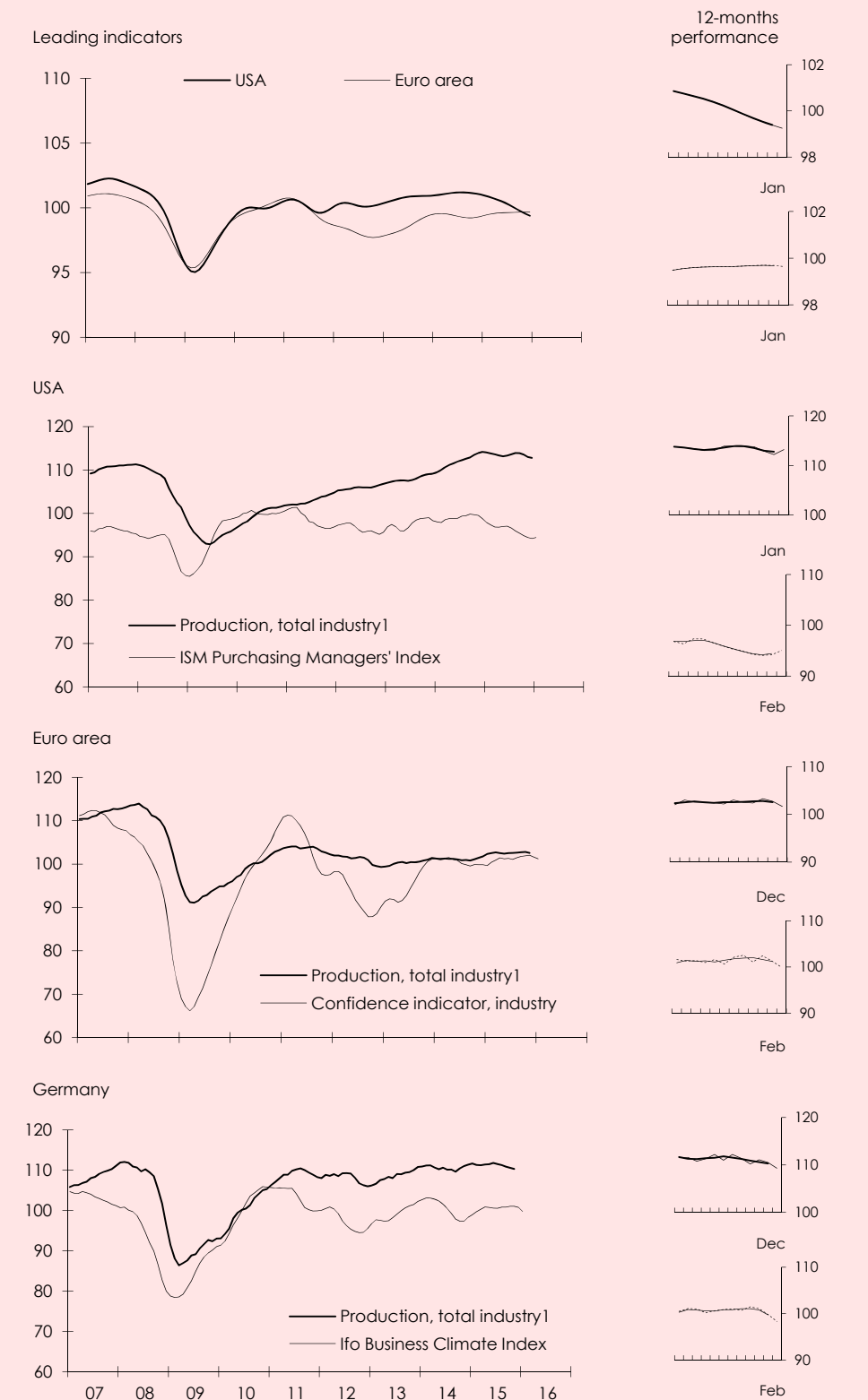
In the USA, growth slowed considerably in the second half of 2015 (fourth quarter +0.3 percent, compared with the previous quarter, third quarter +0.5 percent). Economic activity continues to be supported by the ongoing expansion of personal consumption expenditure. The decline in the unemployment rate and the continuous increase in house prices were conducive to this development. Investment, on the other hand, declined. This probably reflects an increased reluctance to invest in

In the USA, economic activity lost traction in the fourth quarter of 2015; export and investment growth slowed considerably. The structural change in China and the sharp fall in commodity prices continued to weigh on developments in Asian and Latin American emerging market economies.

oil and gas production plants, which are less profitable, given the low commodity prices. Exports even declined in the fourth quarter compared with the previous quarter, owing to the persistently high dollar exchange rate and weak demand from emerging market economies.

Figure 1: International business climate

Seasonally adjusted, 2010 = 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.

Several indicators point to continued sluggish activity in the USA also at the beginning of 2016. The ISM Purchasing Managers' Index, while rising again in January and February, still lies below the expansion threshold. The Industrial Production Index has been largely stagnating for several months. Consumer confidence has also darkened: the Conference Board index declined in February, and the University of Michigan consumer survey also showed a slight deterioration in assessments. Overall, both indices have been moving sideways since the end of 2014, though.

In December 2015, the US central bank ended its zero interest rate policy and for the first time since the financial and economic crisis raised its key interest rate. The determining factor for this decision was the low unemployment rate: it has halved since 2010 and in February 2016 stood at 4.9 percent. In addition, inflation has again risen markedly lately: the core inflation rate (excluding energy and food), which is important for the assessment of domestic inflationary pressures, surpassed 2 percent in January, and consumer price inflation also accelerated. However, with economic activity slowing, the Fed is expected to continue to raise interest rates only very hesitantly.

In China, gross domestic product expanded at a quarter-on-quarter rate of 1.6 percent in the fourth quarter of 2015. For 2015 as a whole, year-on-year growth was less than 7 percent. Hence the constant slowdown of the expansion observed already in recent years continued. Economic expectations point to a further slackening: the Purchasing Managers' Index declined yet again in February.

2. Euro area economic activity remains weak

Economic activity in the euro area lacks momentum. Output grew by a mere 0.3 percent, quarter on quarter, in the fourth quarter of 2015 – as already in the previous three months. In the three largest countries of the euro area, momentum remains subdued: in Germany and France, GDP growth in the fourth quarter remained unchanged at +0.3 percent, quarter on quarter, while in Italy (+0.1 percent) it even slowed. In Spain, by contrast, output continued to grow briskly (+0.8 percent), albeit no longer as vigorously as in the first half of 2015. In the majority of countries, growth was largely driven by domestic demand, while exports mostly weakened, or – as in Germany – even declined compared with the previous quarter. In December, the industrial production index fell both in the euro area as a whole and in all large euro area countries.

The weak basic trend of economic activity is likely to persist in the euro area; economic expectations deteriorated further in February. According to the European Commission's business survey, confidence in the euro area fell in all sectors except for construction. Having temporarily risen, the Economic Sentiment Indicator (ESI) in February dropped again to the level recorded in summer 2015, and thus remained below its long-term average. The outlook darkened in all large countries of the euro area. The loss of confidence was particularly pronounced among consumers and in the industrial sector, where managers gave much more pessimistic assessments of order book levels and production expectations. Overall, the development of the Economic Sentiment Indicator suggests, however, that the economy will grow in the first quarter – albeit at a modest pace.

Labour market conditions are improving further in the euro area. In January, the unemployment rate dropped marginally to 10.3 percent, which was 1 percentage point lower than the year-earlier level. Notably Germany and Spain saw unemployment decline; in France and Italy, the unemployment rate has remained broadly flat in recent months. The lowest unemployment rate was registered by Germany (4.3 percent), the highest by Spain (20.5 percent) and Greece (24.6 percent in November).

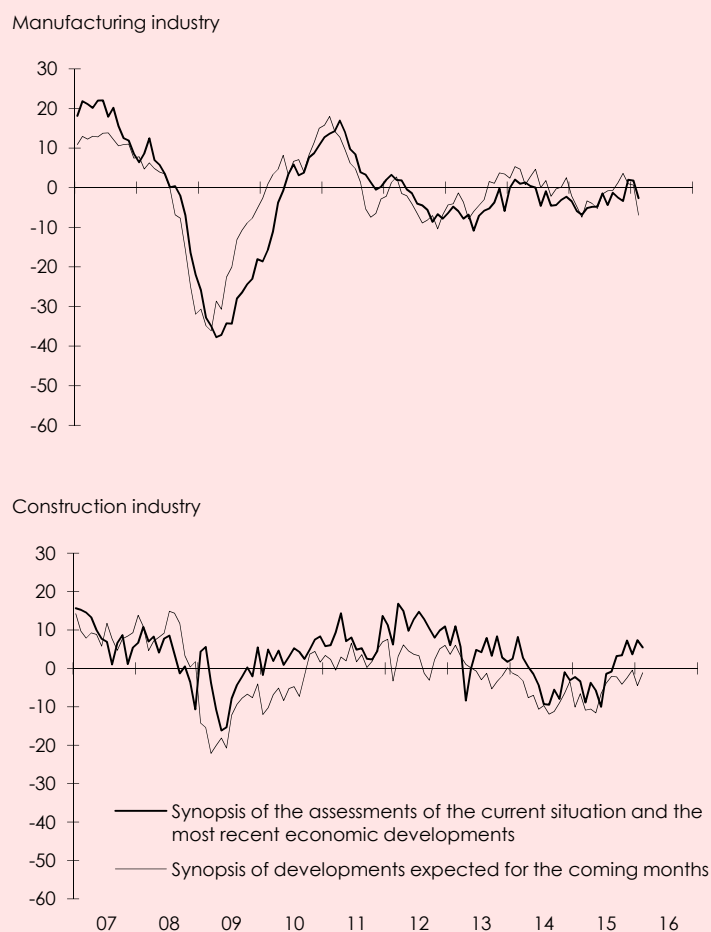
Inflation in the euro area eased further in February, according to the flash estimate: consumer prices even fell compared with a year before (–0.2 percent), largely owing to the decline in commodity prices. Core inflation (HICP excluding energy and unprocessed food), which is better suited for measuring domestic inflationary pres-

Growth of the euro area economy remains subdued. Economic expectations are deteriorating in spite of the expansionary monetary policy. Unemployment is on a persistent downward trend, however.

asures, also fell in February, to +0.8 percent. Against this background, the European Central Bank announced already at its council meeting in January that it would consider further expansionary measures.

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.

3. Austrian economy on slow upward trajectory

In Austria, the sluggish, albeit steady, upward trend continued. Gross domestic product grew by 0.3 percent, quarter on quarter, in the fourth quarter of 2015, the same rate as in the previous two quarters. Year-on-year growth of the Austrian economy for 2015 as a whole therefore came in at 0.9 percent. Private consumption increased only modestly (+0.4 percent), following stagnation in the previous two years.

In the fourth quarter, however, consumption expenditure rose somewhat more briskly than previously in 2015. This was due to increased consumption by private non-profit organisations and the government, reflecting expenditure for the basic care of refugees, whose numbers had risen markedly since the spring. The dynamism of private consumption in the narrower sense of the word remains weak, however – excluding private non-profit organisations, it grew by a mere 0.1 percent, quarter on quarter, in the fourth quarter. Low energy price levels and the prospect of positive effects on incomes from the tax reform from the beginning of January did not increase consumers' willingness to spend at the end of the year. This is also reflected in

Economic growth in Austria remained weak in the fourth quarter of 2015. Export growth was subdued, while gross fixed capital formation grew at a robust pace. Expenditure for refugees' basic care supported consumption.

the consumer confidence indicator according to the European Commission's consumer survey, which remains at a very low level. However, a trend towards a slight improvement in sentiment became apparent from November to February.

Gross fixed capital formation rose again overall in 2015 (+0.4 percent), following a decline in the previous two years; construction investment fell for the third consecutive time, however. At +0.5 percent in the fourth quarter, gross fixed capital formation grew at about the same pace as in the previous two quarters. While construction investment remained flat, investment in plant and equipment increased.

Growth of Austrian exports lost some momentum in the fourth quarter (+0.7 percent, third quarter +1.4 percent), owing to the global economic slowdown. The decline in tourism exports also played a role here. The regional development of exports reflects the uneven dynamics of the global economy. For instance, notably the value of goods exports to the USA and Turkey as well as to the Czech Republic and Poland increased in 2015. The USA replaced Italy as Austria's second most important trading partner, its share in Austria's total goods exports amounted to around 7 percent. Exports to the euro area grew only modestly. Exports to Germany, Austria's largest trading partner, were somewhat higher than last year. By contrast, exports to Asian and Latin American emerging market economies fell slightly, while those to Russia and Ukraine plummeted.

In the first half of the 2015-16 winter season, Austrian tourism revenue was 5,910 million € (+0.7 percent), according to provisional calculations, which represented a slight increase from the same period a year before. Thus real sales almost equalled the year-earlier result (-0.2 percent). From November to January, the number of overnight stays rose by 0.6 percent compared with the same period a year before. Nights spent by foreign guests were slightly lower than a year before (-0.3 percent), while those of resident travellers were markedly higher (+3.4 percent). Notably overnight stays in the Alpine regions for a long time remained below their year-earlier level, given the extraordinarily warm beginning of the winter and the lack of snow until the beginning of January. However, with the snowfalls in January, the end result in these regions improved markedly. Länder with tourism offers other than winter sports even benefitted from the mild weather in the mountains, especially in the first third of the season.

From November 2015 to January 2016, particularly strong increases were registered in tourism demand from Italy (+8.6 percent) and the USA (+8.5 percent) – in the latter case because of price advantages due to the appreciation of the dollar – as well as from the Czech Republic. Demand from Germany and the Netherlands, the most important source countries for Austrian tourism – together they account for around 60 percent of overnight stays by foreigners and 45 percent of overall demand – was uneven at +1.2 percent and -1.2 percent, respectively. Declines were registered in the numbers of nights spent by guests from Hungary and Switzerland, among others. As last year, demand from Russia plummeted (-31.7 percent), clearly reflecting the recession in Russia and the economic sanctions imposed by the EU.

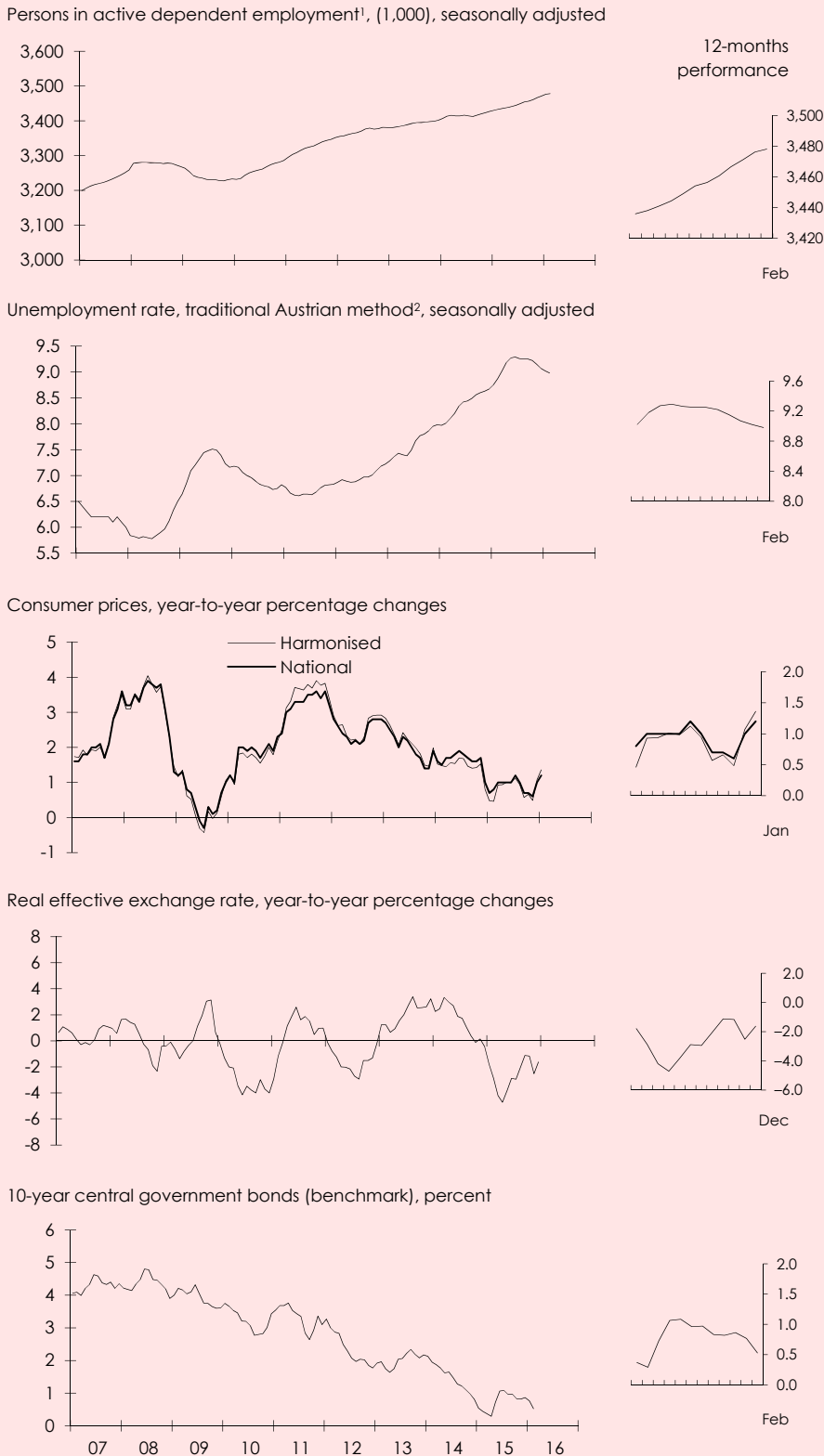
3.1 Darkening of business sentiment

The Austrian economy is likely to maintain its subdued upward trajectory. However, the most recent results of WIFO's Business Cycle Survey show a further deterioration in business sentiment. In February, the assessments of both the present situation and expectations for the coming months were less positive than a month before and considerably poorer than their long-run averages. Both indices remain in positive territory, however. Hence companies still assess the overall economic environment mostly favourably, but do not view it as the normal situation. The weaker international environment is noticeable especially in manufacturing, where the Present Situation Index declined markedly and entered negative territory. Notably order book levels were assessed more pessimistically than of late. This appraisal confirms the most recent development of the production index for the manufacturing sector, which fell for the second consecutive time in December. According to WIFO's Business Cycle Survey, companies' expectations deteriorated even more than their assessments of the present situation, and were clearly negative in February. Overall,

According to WIFO's Business Cycle Survey, firms' assessments of economic conditions have deteriorated. Particularly assessments given by manufacturing firms have been negative lately. Expectations are somewhat better in construction and the services sector.

assessments were more positive in the capital goods sector than in the consumer goods sector; this reflects the persistent weakness of consumer demand. The Bank Austria Purchasing Managers' Index, by contrast, rose for the second consecutive time in February and indicates an expansion in the manufacturing sector.

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.

Slightly better assessments than in manufacturing were given by firms in the construction and services sectors, according to WIFO's Business Cycle Survey of February. In these sectors, the assessment of the present situation deteriorated somewhat, but remained in positive territory. Expectations for the coming months improved, although negative assessments still predominate in construction. WIFO's Leading Indicator, a weighted index made up of ten indicators from the real economy and the financial sector, declined for the second consecutive time, according to the most recent analysis, and now lies at a level similar to that recorded in March 2015. However, the downward movement was considerably stronger than the one experienced a month before. This points to a slight slowdown in economic activity.

3.2 No improvement in labour market

The labour market situation in Austria is still not improving markedly. The number of persons in dependent active employment did increase by around 46,000 (+1.4 percent), year on year, in February, according to provisional estimates. The number of job vacancies also increased noticeably (+10,500). But the number of persons registered as unemployed with Public Employment Service Austria (AMS) also rose somewhat (+8,100, +2 percent). The total labour force grew further.

As already in previous months, unemployment no longer rose further on a seasonally adjusted basis, however, but even declined compared with the previous month (-1,800 persons, -0.5 percent). An important contributing factor to this decline, in addition to the sluggish upward trajectory of economic activity, was the particularly mild weather this winter. The unemployment rate remained steady at 9.0 percent. The harmonised unemployment rate according to Eurostat stood unchanged at 5.9 percent in January.

3.3 Inflation rising again for first time in January

Consumer prices rose by 1.2 percent in January compared with a year before. Thus the inflation rate was slightly higher than in December 2015 (+1.0 percent). As in previous months, downward pressures on prices came from the sharp decline in crude oil prices. In January, Brent crude oil temporarily traded at less than 30 \$ per barrel, and its monthly average price was around 35 percent lower than a year before. The prices of heating oil (-21.2 percent, year on year) and fuels (-9.8 percent) declined considerably. Upward inflationary pressures once again came from hotel and restaurant services, clothing, insurance services and rents. The Harmonised Index of Consumer Prices (HICP) in January stood 1.4 percent above its year-earlier level. Hence inflation was considerably higher in Austria than in Germany (+0.4 percent) and in the euro area as a whole.

The labour market situation in Austria remains difficult. While the number of persons employed and job vacancies have increased, the seasonally adjusted unemployment rate remains high.

The sharp fall in commodity prices continues to dampen inflation. But the prices of services, clothing and rents rose in January.