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Positive Growth Continues

Business Cycle Report of May 2018

Positive Growth Continues. Business Cycle Report of May 2018
In the first quarter of 2018, the Austrian economy grew by 0.8 percent compared to the previous quarter, thus similar to the course of the previous year. Along with a buoyant domestic economy, that growth is underpinned by foreign trade, stimulated by a dynamic global economy. In line with that, the Austrian labour market is also continuing to show a positive trend.

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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: 9 May 2018.

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Expansion of the global economy accelerated in 2017. Production has increased sharply in advanced and emerging economies alike. The strong global economy has also resulted in increased demand for commodities, leading to a tendency towards a rise in commodity prices. That in turn favours commodity-exporting emerging countries, whose economies suffered from the sharp decline in commodity prices over recent years. World trade has expanded strongly of late, suggesting that the upturn in the global economy remained on a firm footing in early 2018. Survey-based indicators support the positive outlook for continued stable growth in the first half of 2018. Among the countries for which preliminary estimates for the first quarter of 2018 are already available expansion is continuing, though it has slowed somewhat.

The Austrian economy is currently booming. In the first quarter of 2018, economic output once again grew strongly, with the momentum of the previous year continuing into the first half of 2018. The key sentiment indicators reached new highs at the end of 2017, though they declined slightly in early 2018. They continue to point to strong growth, but there is no sign of further acceleration over the coming quarters.

Today's strong economy is sustained by foreign trade and gross fixed capital formation. It is also fuelled by an increase in private consumption. The Austrian economy is expected to maintain this momentum over the coming months. Businesses have a positive view of the current situation and remain optimistic about the future. In addition, the favourable financing environment is supporting the investment cycle.

The Austrian labour market is also showing a positive trend. According to preliminary estimates, the number of persons in active dependent employment was 91,000 higher in April than in the previous year (+2.6 percent). Particularly in the manufacturing sector, the strong economic situation was reflected in a steep rise in employment for the year to March. Demand for labour was also high in the construction industry and in sectors closely linked to manufacturing. The seasonally adjusted unemployment rate remained at 7.8 percent in April (national definition).

Inflation (CPI) rose by 0.1 percentage point to 1.9 percent (HICP +2.1 percent) in March. The costs of housing, water, energy, restaurants and hotels were the main contributors to the rise in prices. The inflation differential of +0.8 percentage points to the euro area average remained unchanged compared to February.

1. Global economy continues to pick up

In early 2018, the global economy is continuing its upswing. Survey-based leading indicators remain at a high level.

Expansion of the global economy accelerated in 2017. Currently available data on GDP growth indicate continued expansion in the first quarter of 2018, with growth in the USA proving particularly robust at +0.6 percent compared with the previous quarter. Economic activity is also buoyant in Japan, helped by economic policies and the recovery in international demand. By contrast, real GDP growth in the UK remained subdued in the first quarter of 2018 despite recovery in the second half of 2017. In France, growth in the first quarter of 2018 was lower than in any quarter in the previous year, but that is likely to have been mainly the result of special factors such as the high number of strike days.

In the emerging markets, overall economic output is continuing to accelerate. In China, economic growth was again strong despite the expiration of its fiscal stimulus package and a tightening of monetary policy. In parallel, growth in India again picked up significantly in the second half of 2017 after losing considerable momentum as a result of extensive economic policy reforms. Brazil and Russia have continued their recovery from the deep recessions of 2016, though growth rates in both countries remain subdued.

Survey-based indicators point to sustained growth of the global economy in the first half of 2018. The J.P. Morgan Global All-Industry Purchasing Managers' Index fell to 52.8 points in April from 53.3 points in March.

General conditions in the global financial markets continue to support real economic activities, but have tightened over recent months.

Following the surge in share prices over the last few years, share prices fell sharply at the beginning of 2018, accompanied by greater volatility in the stock markets. The turbulence of the financial markets was largely limited to the stock markets but against a backdrop of steadily rising inflation forecasts. Within that context, yields on long-term government bonds in the USA picked up, an indication for tightening monetary policy more quickly. The federal funds rate futures curve has gone up several times in recent weeks following the interest rate hike of December 2017. The Bank of Japan, on the other hand, is pursuing a highly expansionary policy and is keeping yields on 10-year bonds close to 0 percent as part of its yield curve control policy. The People's Bank of China is continuing its programme to tighten lending introduced in 2017 in an attempt to curb the leverage effect in the financial system and strengthen overall financial market stability. In Brazil and Russia, key interest rates were once again lowered as inflationary pressures continued to ease.

In the USA, real economic activity remains robust due to solid domestic demand. The latest tax reforms are also designed to stimulate growth.

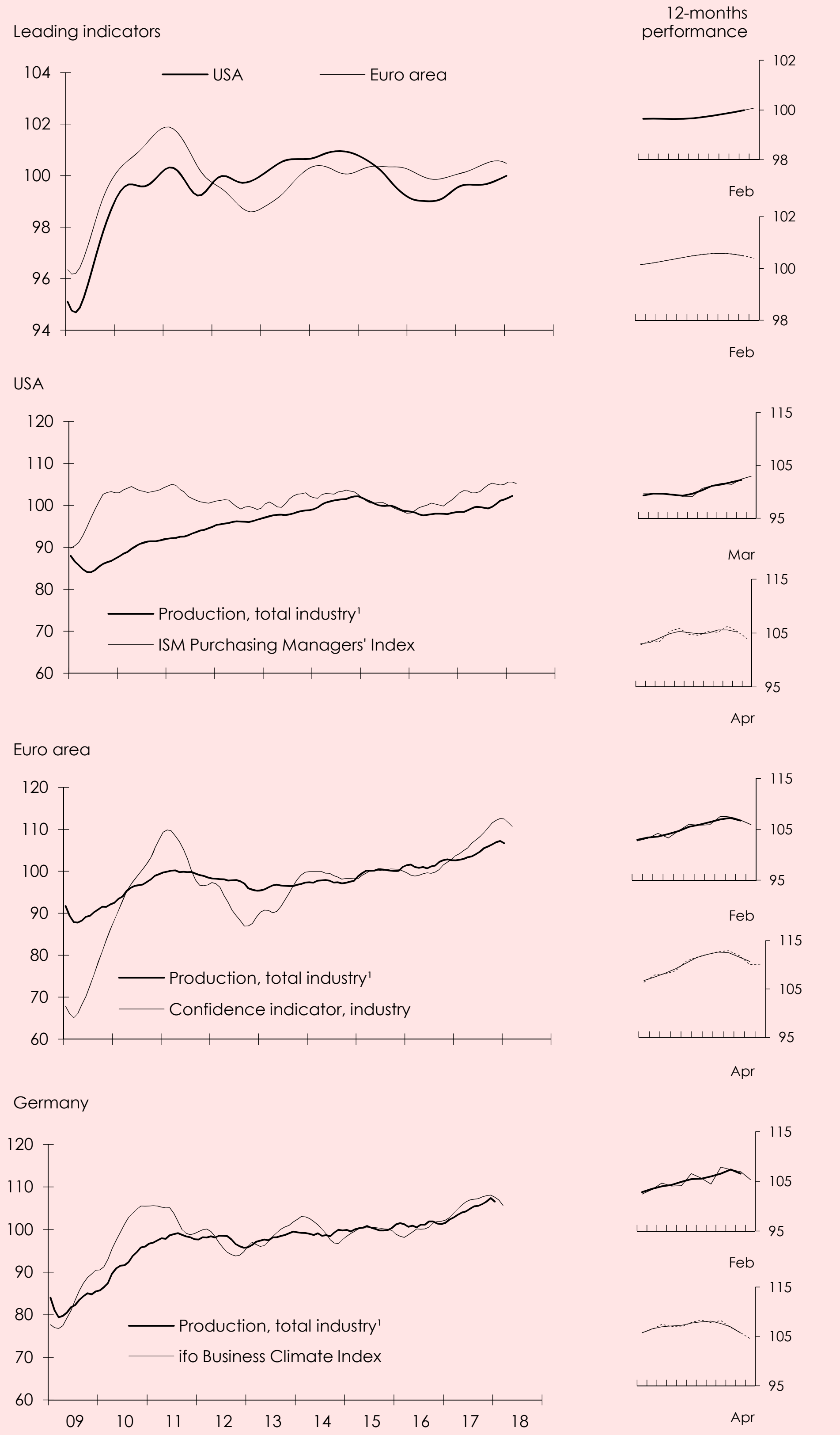
The continuing expansion of the economy in the USA is being driven by solid growth in investment and consumer spending. Private consumption is being fuelled by a number of factors – wage growth is gradually picking up due to the strain on the labour market, while high asset prices are encouraging private households to spend (wealth effect)[1]. The sustained economic upswing has brought the unemployment rate down to its lowest level in 18 years. Long-term unemployment and involuntary part-time employment have also fallen significantly. The adoption of tax reform legis-

[1] The wealth effect is based on the premise that a change in the value of assets (financial assets, tangible assets etc.) induced by a change in asset prices is accompanied by a corresponding change in consumer spending. The wealth effect is usually positive: consumer spending moves in the same direction as the change in the value of the asset. That effect arises from two different channels. First, the wealth effect relates to the psychological effect of increases in value. Second, it describes the possibility of borrowing more in an environment of rising asset prices, and thus financing higher consumer spending; in this case, assets act as collateral, such as for consumer loans.

lation in December 2017 and the increase in ceilings for government spending that was agreed in February are likely to boost domestic demand still further.

Figure 1: International business climate

Seasonally adjusted, 2015 = 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.

The euro area countries are still enjoying strong economic growth across all countries and sectors. However, growth weakened slightly in most countries in the second half of 2017.

The upswing in the euro area countries is continuing in 2018.

Real GDP grew by 0.7 percent in the fourth quarter of 2017 compared to the previous quarter. To date, economic output has therefore risen significantly faster than productive potential. The increase was driven by both foreign trade and domestic demand, in particular gross fixed capital formation, while changes in inventories and net acquisitions of valuables made a negative contribution. The economic indicators and flash estimate for the first quarter point to growth continuing in the first half of 2018.

In 2017, for the third year in a row, Spain and the Netherlands recorded the highest growth rates among the major euro area countries. The French economy grew strongly, though at a somewhat lower rate in the first quarter of 2018, which was probably due to the unusually high number of strike days.

That strong economic growth led to appreciable recovery of the labour market, particularly in 2017. Over the course of 2017, the unemployment rate fell by 1 percentage point to 8.6 percent. In February and March 2018 it stood at 8.5 percent, the lowest level since the beginning of 2009.

Central and Eastern Europe is still experiencing an economic boom, which is now reflected in rising inflation.

In the Central and Eastern European countries (CEEC 5), overall economic output continues to grow rapidly. Exports are benefitting from the upswing in the euro area and Russia. In addition, increased employment and strong growth in real incomes are leading to a significant increase in household spending. That environment is encouraging businesses to ramp up capacity. In 2017, investment increased in all Central and Eastern European countries. The increased inflow of funds from EU subsidy programmes since the beginning of 2017 has contributed to that investment boom. The buoyant economy is also having an impact on the labour market. Poland, the Czech Republic and Hungary currently have almost full employment, with labour shortages leading to an appreciable increase in labour costs for industry.

2. Strong growth at the start of the year

According to the latest WIFO Flash Estimate, the Austrian economy grew by 0.8 percent in the first quarter of 2018 compared to the previous quarter (trend-cycle component). That growth was fuelled by both domestic demand (consumption, investments) and foreign trade. The industrial sector remained strong, and the service sectors also expanded once again.

In early 2018, growth of the Austrian economy was similar to in previous quarters, so the boom is continuing. Unadjusted GDP rose by 3.1 percent year-on-year in the first quarter. The result was influenced by a positive Easter effect on the one hand and fewer working days on the other (–0.5 working days).

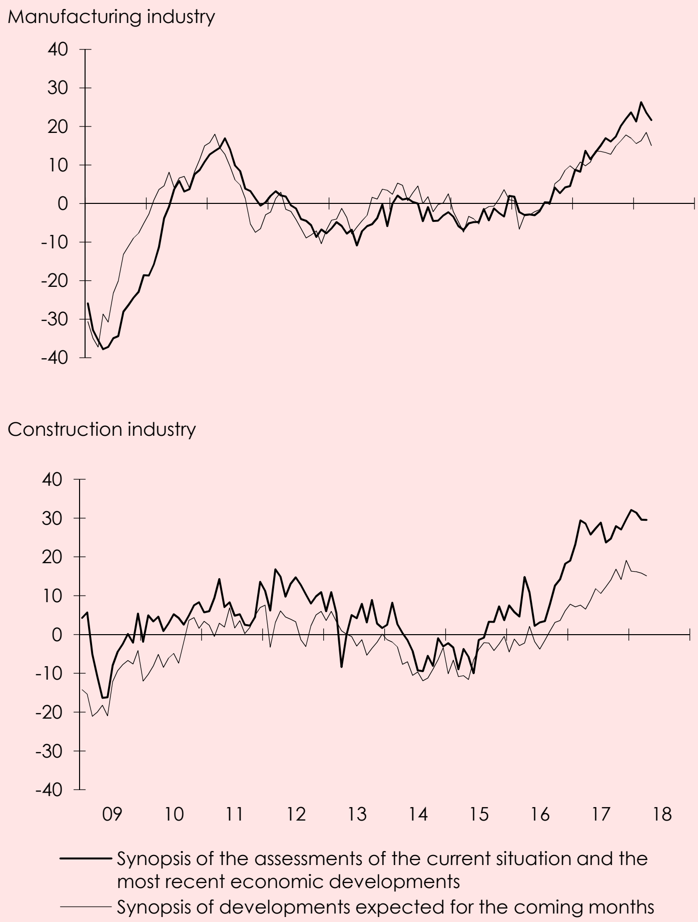
The results for the fourth quarter of 2017 have also been revised upwards as part of the current calculation. According to current estimates, that will result in real growth of 3.0 percent for 2017 as a whole.

The expansion is broad-based – both domestic demand and foreign trade have contributed to the upswing. At +0.3 percent, household consumption in the first quarter was again significantly higher than in the previous period. Public consumption grew at a similarly strong rate. Investment demand is also continuing to experience a positive trend, with gross fixed capital formation growing by 0.8 percent, similarly to in the previous quarter. The expansion of foreign trade slowed down in the first quarter, but continued to make a positive contribution to growth, as exports grew more strongly (+0.8 percent) than imports (+0.5 percent).

Income grew strongly also in the first quarter. The 1.2 percent increase in wage income (compensation of employees) compared to the previous quarter reflects the sustained increase in nominal wages and employment overall. Capital income from production (gross operating surplus and mixed income) of +2.1 percent in the first quarter of 2018 significantly exceeded the high growth rates of the previous year. It thus once again rose significantly faster than wage income owing to its greater dependence on the economic cycle: in this period of economic boom, productivity and profits are rising rapidly, while contractually agreed wage incomes are lagging behind considerably. That gap was particularly pronounced in 2017, with a 3.5 percent rise in wage income against a 6.4 percent increase in capital income.

Figure 2: Results from the WIFO-Konjunkturtest

Indices of the assessment of the current economic situation and of business expectations, seasonally adjusted



Source: WIFO-Konjunkturtest. Data refer to index points (percentage points) between +100 and –100. Values above 0 imply positive expectations, values below 0 indicate negative expectations.

3. A few minor concerns

The leading indicators continue to paint a bright picture, though some indicators have recently declined.

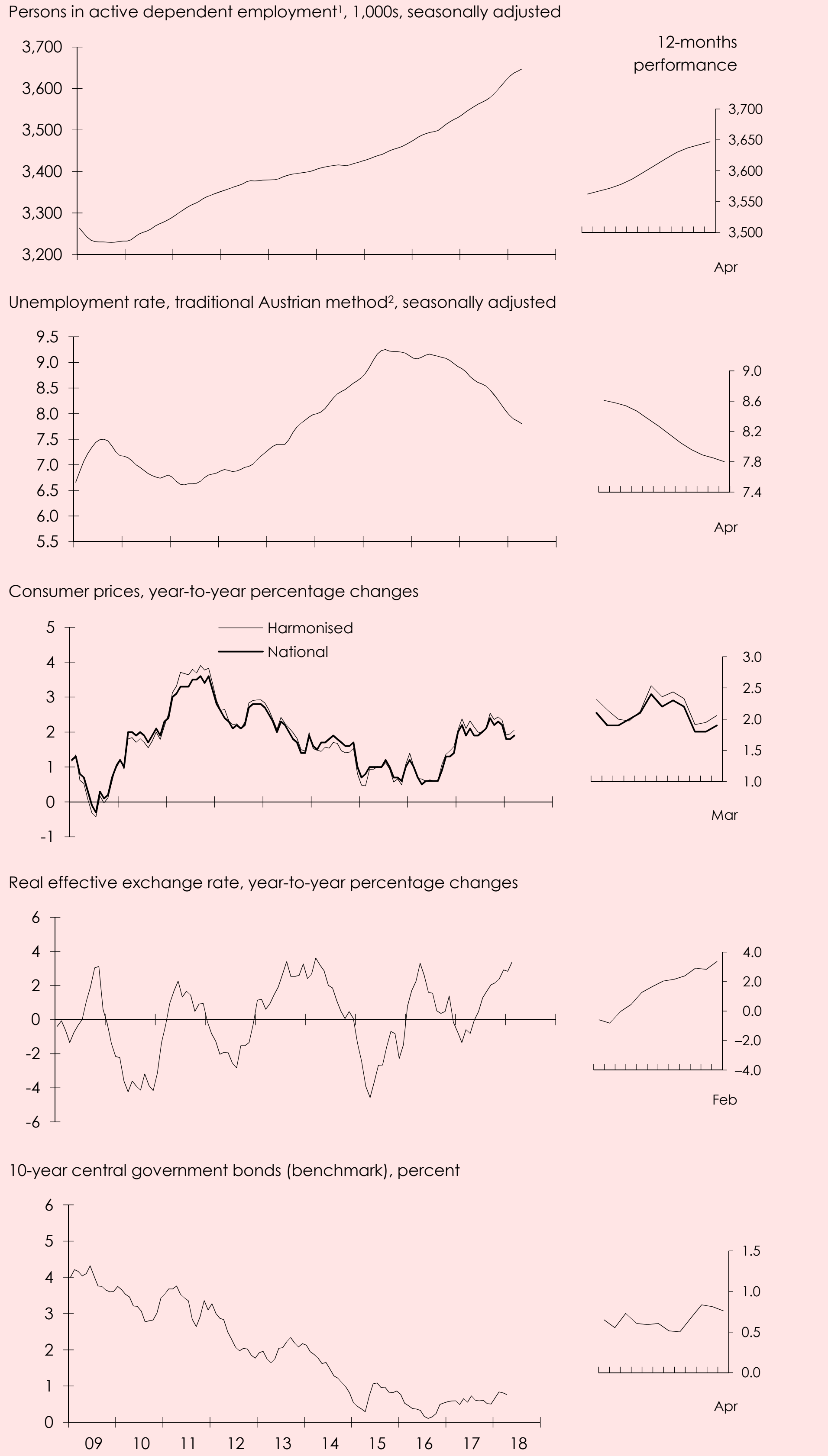
In April 2018, for the first time since the beginning of the upswing, the WIFO-Konjunkturtest (business cycle survey) shows a clear decline in business confidence among Austrian companies, with growth expected to be slightly slower over the coming months. However, the mood remains very positive.

At 21.3 points in April, the index of current business assessments was only 2.7 points below the figure for the previous month and 5.4 points below its high of February. In the construction sector the index remains very high at 29.5 points. The index also showed a decline in the service sector, but at 19.4 points continued to indicate a good service economy. In the manufacturing sector, which significantly impacts the economy, a decrease of 1.9 points was recorded but the index remained within the range of very positive economic assessments at 21.6 points.

The business expectations index also fell in April. Despite the decline of 2.7 points to 17.6 points, on balance, the service industries remained optimistic about future growth. The confidence of the construction industry likewise remained strong, with only a slight decrease recorded (–0.7 points). At 15.0 points, the manufacturing sector remained similarly optimistic, despite a decline in the indicator.

The UniCredit Bank Austria Purchasing Managers' Index also pointed to a sustained growth trajectory, remaining at 58 points in April after a steady drop from its all-time high at the turn of the year.

Figure 3: Key economic indicators



Source: Public Employment Service Austria, Main Association of Austrian Social Security Institutions, Oesterreichische Nationalbank, Statistics Austria, WIFO calculations. – [1] Excluding persons in 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.

WIFO's Leading Indicator also remained unchanged in the most recent evaluation compared to the previous month. The sub-indicators have recently shown a highly heterogeneous trajectory – domestic indicators mostly declined or did not change, while some international indicators improved again (e.g. production expectations). Overall, the indicator remains at a high level, reflecting a favourable economic trend.

4. Moderate price rises despite strong growth

In March, inflation increased slightly in Austria. The costs of housing, water, energy, restaurants and hotels were the main contributors to the rise in prices.

According to calculations by Statistics Austria, the inflation rate of 1.9 percent in March 2018 was only slightly higher than in the previous month (February +1.8 percent). Nevertheless, it is still significantly below the rate during earlier phases of strong economic growth.

In March, inflation was again above the euro area average (HICP Austria +2.1 percent, euro area +1.3 percent). The gap of 0.8 percentage points was the same as in the previous month.

Housing, water and energy prices saw the highest year-on-year increases (+2.0 percent on average), with the +4.1 percent rise in rentals for housing having a major impact here. Household maintenance costs went up by 1.8 percent. Household energy prices increased only slightly (+0.4 percent on average), as the fall in gas prices (–5.9 percent) almost compensated for the increases in solid fuels (+5.7 percent) and heating oil (+3.1 percent). Electricity became 0.2 percent cheaper, while heat energy became 1.6 percent more expensive. Prices charged by restaurants and hotels went up by an average of 3.1 percent. That was almost exclusively due to the increase in the cost of catering services (+3.2 percent). The cost of accommodation services increased by 2.8 percent. In the transport sector, the average inflation rate was 1.4 percent (repairs of personal transport equipment +2.9 percent, air tickets +8.3 percent). Fuel prices rose slightly less in March (+0.5 percent) than in February (+0.9 percent).

5. Positive labour market trend continues

The sharp rise in employment continued in April. That is increasingly benefitting the long-term unoccupied persons registered as unemployed too.

The buoyant economy is also having a clear impact on the Austrian labour market. According to preliminary estimates, the number of persons in active dependent employment in April was 91,000 higher than in the previous year (+2.6 percent). Seasonally adjusted, the increase over the previous month was 4,900 (+0.1 percent). Since summer 2017, there has been an appreciable rise in employment, especially in sectors that significantly impact the economy such as manufacturing. Demand for labour was also high in the construction industry and in sectors closely linked to manufacturing such as other business services and transport.

The number of unemployed registered with the Public Employment Service Austria (AMS) in April was 29,100 lower than in the previous year (–8.6 percent), and 29,200 (–7.1 percent) lower when including people undergoing training. Seasonally adjusted unemployment fell by 0.5 percent compared to the previous month. According to the national definition, the seasonally adjusted unemployment rate remained at 7.8 percent in April. The year-on-year decline was 0.9 percentage points. The long-term unoccupied persons registered as unemployed are now increasingly benefitting from the recovery of the labour market (–11.2 percent year-on-year).