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Solid Growth of Export Industries: Energy Costs Rising Substantially

Activity in the export-oriented sectors is expanding strongly. Firms' optimism on the short-term outlook is unabated, and the odds are for a revival of investment. However, the strength of the euro and high energy prices are weighing on the cyclical recovery. The level of unemployment remains high.

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The business climate in Austrian manufacturing is highly favourable. In the WIFO business survey of October, the proportion of firms expecting further output gains outweighs the pessimists by a margin of 13 percentage points. Also judgements on the business situation six months from now have turned more optimistic. Data on actual production, though lagging considerably behind the survey indicators, also point to solid growth. For the period of June to August, the production index adjusted for calendar effects rose by 9 percent from one year ago. The motor car industry expanded particularly strongly in the same period, with output exceeding the year-earlier level by more than one-third. The positive trend is confirmed by the foreign trade statistics. Domestic companies benefit from the close supply relations with the booming export industries in Germany. Incoming orders from South-East Europe, the new EU member states and the USA also posted sizeable gains.

The strong increase in output is leading to rising utilisation of productive capacities, which at a seasonally adjusted 82.4 percent in the fourth quarter came to exceed slightly its long-term average. In this way, the conditions for a revival of investment have improved. Such revival is indeed being suggested by the results from the WIFO investment survey of last summer and the increase in imports of machinery by 11 percent year-on-year between June and August.

The cyclical risks relate to the high euro exchange rate and the high energy prices. In early November, the euro rose to a high of 1.29 \$ per euro. The currency appreciation is undermining the price competitiveness of exports and may render Europe as target for foreign direct investment less attractive.

The strong euro is dampening the impact of the rise in commodity prices on world markets only to a small extent. The price hikes are the result mainly of lively demand from China and other parts of Asia, as well as of speculative behaviour in view of the political risks in the Middle East. In October, the world market price of crude oil on a euro basis was up by 51 percent from last year, that of metals and other raw materials by 13 percent. The shift in the terms-of-trade against the commodity-importing countries is being clearly felt on the consumer level: in Austria, the increase in consumer prices for housing and energy items of 4 percent and for transportation of 3 percent year-on-year in the third quarter 2004 was well above the overall index increase. The latter accelerated to 2.2 percent, of which around 0.5 percentage point were due to the direct effect of higher energy prices. Thus, headline inflation in the third quarter was stronger than the gains in the contractual wage index or in employees' nominal per-capita income.

Retail sales have so far not suffered from the squeeze in real disposable income. In July and August, they rose by 3 percent or more in volume above the low level of

last year. The additional spending on energy reduces in the first instance the proportion of saving in disposable income, before weighing on consumption growth in the medium term. Registrations of new passenger cars also increased substantially. Wholesale trade, gaining 4.2 percent in volume year-on-year in July and August, is benefiting from buoyant foreign trade.

The positive trend in the trade sector is being mirrored by the marked increase in the number of jobs, which in the third quarter was higher by 6,500 or 1.3 percent compared with one year ago. For the major part, however, the newly created jobs are part-time. Also in manufacturing, the job situation is reacting to the healthy growth of output, with the fall in employment having virtually bottomed out. Unemployment nevertheless fails to decline, largely because of the marked increase in foreign labour supply. In October, the seasonally adjusted jobless figure stood at 243,400, up by 800 from last year. Allowing for the higher number of people enrolled in vocational training, the "real" increase in unemployment amounts to 6,000. There have been 10 jobseekers for each vacancy reported to the labour market service.