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Domestic Demand Drives Economic Upswing in Austria

Business Cycle Report of February 2017

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Austria's real gross domestic product rose by 0.5 percent, quarter on quarter, in the fourth quarter of 2016, according to WIFO's latest Flash Estimate (trend-cycle component). Hence the underlying pace of economic expansion in Austria in the fourth quarter was unchanged from the previous quarter. Domestic demand was the main driver of the expansion, whereas net trade did not contribute significantly to growth. The picture painted by leading indicators is improving further, suggesting that economic activity will accelerate in spring 2017.

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The global economy (G 20) continued the stable growth seen in the first half of 2016 in the third and fourth quarters of 2016. In addition to the continuing strong momentum in Asian emerging market economies, economic activity improved also in large commodity-exporting countries, following the recession in recent years. In China, the robust expansion experienced in the fourth quarter of 2016 continued also in the fourth quarter, with output rising by 6.7 percent in 2016 as a whole. Among the advanced economies, notably the USA registered a substantial improvement in the second half of 2016, while developments in the euro area remained stable. Global economic growth is expected to accelerate further in the coming months, driven by the still robust expansion in leading advanced economies and the pick-up in activity in several large emerging market economies. While leading indicators signal a positive outlook for global economic activity, considerable downside risks stemming increasingly from growing economic policy uncertainty persist.

In Austria, growth accelerated in the second half of 2016. The driving forces are robust and rest on the domestic economy. The basic trend of economic activity continues to point upward. Hence the upswing observed since 2015 persists; in recent months it has again been mainly supported by growing domestic demand: household consumption continued to increase briskly also in the fourth quarter, alongside with rising public consumption. In addition, domestic companies have been stepping up their investment since 2015. Net trade, by contrast, did not make a substantial contribution to economic growth.

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.

Inflation has accelerated of late, in line with favourable economic conditions and rising commodity prices. CPI rose by 1.4 percent, year on year, in December 2016 (November +1.3 percent). HICP inflation was +1.6 percent, still significantly higher than the euro area average (+1.1 percent), but for the first time lower again than the German inflation rate (+1.7 percent). Employment continued to grow in January, with the seasonally adjusted number of persons in active dependent employment rising by 4,500 compared with a month before, and by 58,000 or 1.7 percent compared with a year before. In January, the unemployment rate (seasonally adjusted) stood at 8.9 percent.

1. Global economic growth remains stable

Global economic activity remained resilient also in the second half of 2016. In addition to the continuing strong momentum in Asia, the improvement in emerging market economies overall is also a result of favourable developments in large commodity-exporting countries, where, following the recession experienced in recent years, increased evidence is emerging that a recovery is under way. In China, the robust expansion continued in the fourth quarter, with economic growth for 2016 as a whole coming in at 6.7 percent. At the same time, economic activity in advanced economies remained resilient. The favourable development of the global economy is also reflected in a substantial increase in commodity prices. As a result, especially the commodity-exporting countries of Latin America and the Middle East (Iran, Saudi Arabia, Kuwait) may head into an expansionary phase. Leading indicators signal a continued positive growth momentum for the global economy; Markit's global composite Purchasing Managers' Index, for instance, remains at a consistently high level. However, contrary to the favourable picture portrayed by leading indicators, recent efforts aimed at increased protectionism as well as growing economic policy uncertainty in general may dampen the outlook.

1.1 Domestic activity driving economic growth in the USA

US GDP advanced by 0.5 percent, quarter on quarter, in the fourth quarter of 2016, according to provisional estimates, somewhat more slowly than in the third quarter. GDP growth for 2016 as a whole was 1.6 percent. In the fourth quarter of 2016, the dynamism in consumer spending of households remained a relatively strong driver of the expansion, although real disposable income growth flattened somewhat over the course of 2016. Investment expanded markedly in the fourth quarter, contributing much more strongly to GDP growth than in previous quarters. Notably machinery and equipment investment and residential investment posted sharp increases. But inventory investment also made a sizeable contribution to growth, after a phase of weakness observed since the beginning of 2016. Net trade exerted an unexpectedly strong dampening effect: a noticeable increase in imports was counterbalanced by a marked decline in exports.

The high production level is now also increasingly reflected in price dynamics. The annual rate of change in CPI was +2.1 percent in December 2016, noticeably higher than in November (+1.7 percent). Core consumer price inflation (which excludes energy and food) rose by 2.2 percent, year on year, in December.

Given the favourable picture portrayed by leading indicators and the improvement in key economic data, a similar result as in the fourth quarter of 2016 is expected for the first quarter of 2017. The leading indicators portray a positive picture for the USA overall. This appears quite remarkable, given the current environment of increased economic policy uncertainty. The indicator for economic policy uncertainty in the USA rose significantly towards year-end¹. Economic activity and the picture portrayed by leading indicators in general have been quite resistant vis-à-vis the recent drastic increases in policy uncertainty measures.

Economic activity in the USA gained momentum in the second half of 2016. The favourable picture portrayed by leading indicators suggests that current developments are similarly stable. However, increasing economic policy uncertainty is dampening growth prospects.

¹ Compare Baker, S.R., Bloom, N., Davis, St.J., "Measuring Economic Policy Uncertainty", CEP Discussion Papers, 2015, (dp1379).

In financial markets, expectations of a substantial expansion of public investment despite already high levels of public indebtedness have, on the one hand, led to a deterioration in financing conditions in the form of a marked increase in long-term interest rates. On the other hand, the low levels of a number of risk aversion indices reflect the positive business sentiment overall. For instance, the S&P 500 implied volatility is extremely low, and recently the dollar has also appreciated steadily in nominal effective terms.

1.2 Sentiment improves markedly in the EU

Economic developments in the EU countries in the second half of 2016 were similarly stable as in the first half. According to provisional estimates, real GDP rose at a quarter-on-quarter rate of 0.6 percent in the EU and 0.5 percent in the euro area in the fourth quarter of 2016. Among the countries for which data are already available, Spain and the UK recorded similarly brisk growth in the fourth quarter as in previous quarters. In Belgium and France, GDP growth accelerated slightly compared with the third quarter.

Leading indicators suggest that the favourable economic development will continue. For instance, the composite Purchasing Managers' Index for the euro countries was clearly in positive territory in January. The sub-index for services deteriorated somewhat, while the sub-index for industry rose to the highest level recorded in almost six years. France registered an increase, while Germany experienced a slight decline. The positive outlook suggested by the Purchasing Managers' Index is being supported by the EU Business and Consumer Survey indicators. In January, the European Commission's Economic Sentiment Indicator (ESI), which depicts the economic climate in the EU, rose slightly in the euro area and fell somewhat in the EU, notably as a result of the deterioration in the UK. The ESI readings for the euro area and for the EU as a whole differ slightly only for the services sector. The indicator shows a mixed picture for the five largest euro area economies: while it picked up in Italy, Spain and the Netherlands, it fell in Germany and France.

At the beginning of 2017, leading indicators suggest that economic developments in the EU countries will remain positive.

2. Economic upswing underway in Austria

Austria's GDP expanded by 0.5 percent, quarter on quarter, in the fourth quarter (according to WIFO's latest Flash Estimate), the same rate as in the third quarter. Compared with a year before, unadjusted GDP increased by 1.8 percent. The seasonally and working day adjusted rate of change (key figure according to Eurostat standard) even came in at +0.6 percent. Hence the increase for 2016 as a whole was 1.5 percent.

Growth in the fourth quarter was once again determined by lively domestic demand. Both consumption and investment were widened out notably.

Private consumption remained buoyant also in the fourth quarter, and at +0.5 percent increased considerably more briskly than public consumption (+0.3 percent). Gross fixed capital formation grew at a somewhat slower pace in the fourth quarter than in the preceding quarters. Companies once again stepped up their equipment and machinery investment, while the demand for buildings declined. Recently, the dynamism of exports has improved again moderately, following a slight slowdown in the third quarter. But with exports growing at a slower pace (+0.4 percent) than imports (+0.5 percent), net trade once again did not contribute positively to economic growth in the fourth quarter.

On the supply side, notably industry provided a marked boost to the economy. Manufacturing gained momentum in the fourth quarter (value added +0.8 percent). Economic growth was also supported by market services. Value added in the trade sector grew by 0.4 percent, compared with +0.5 percent in accommodation and food services activity sector. By contrast, developments in the construction industry have been weak recently, with value added contracting by 0.1 percent in the fourth quarter.

Economic growth in Austria has been accelerating since the second quarter of 2016. Hence the economic upswing, which started already in 2015, has strengthened.

2.1 Further improvement in leading indicators

The picture portrayed by leading indicators has improved further on a broad basis. As the results of WIFO's Business Cycle Survey show, companies judged economic conditions positively also in January. The current situation index for the economy as a whole rose again in January, signalling overall exceptionally optimistic assessments of economic conditions especially in manufacturing. Assessments in the construction and services sectors remained unchanged. Notwithstanding a slight decline in the business expectations index, companies displayed sustained confidence regarding the outlook for the coming months in January. The index still shows increasingly optimistic expectations in construction; it fell in manufacturing, albeit remaining in clearly positive territory. A more marked decline was registered in the services sector, but the sub-index also indicates an optimistic assessment.

The picture portrayed by leading indicators is improving steadily, with Austrian companies' assessments of the business outlook occasionally varying across sectors, though.

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.

The Bank Austria Economic Indicator also points to continued positive developments. It has risen considerably of late, reaching its highest level in over five years, notably as a result of the brightening consumer sentiment. Similarly, the Bank Austria Purchasing Managers' Index released at the end of January suggests that the upward trend experienced in the production sector in recent months will persist. The

index has risen briskly of late, to 57.3 points, primarily owing to the noticeable expansion of production – the sub-index for production climbed to 59.5 points, its highest reading since April 2011.

WIFO's Leading Indicator also posted yet another and once again extraordinarily brisk month-on-month increase, according to the latest analysis.

2.2 Decline in overnight stays in winter season so far

In the first two months of the current 2016-17 winter season (November and December 2016), sales declined by 3.5 percent in nominal terms, to 3,190 million € (adjusted for price changes, -4.2 percent), according to estimates by WIFO. The number of overnight stays also fell in the first third of the winter season (-4.2 percent). Hence the "real expenditure per overnight stay" quality indicator stagnated. The demand from domestic guests increased (+1.7 percent), while a decline was registered in foreign source markets (-6.6 percent), notably in December (-9.4 percent). Arrivals, by contrast, reached a new peak. The average length of stay fell to 2.8 days.

The highest increases in the number of overnight stays were recorded for guests from Romania as well as Hungary, France and the USA. Overnight stays by travellers from Russia increased for the first time since 2014. While the demand from the UK almost reached the year-earlier level, despite the weak pound sterling, the demand from Poland and Switzerland fell somewhat more markedly.

As regards the individual types of accommodation, developments were quite mixed in November and December 2016, though altogether subdued: while commercial and private holiday apartments as well as private accommodation recorded sharp declines in overnight stays, the entire hotel sector was above-average, with the 5/4-star segment registering the smallest declines. By contrast, the other types of accommodation taken together recorded an increase in overnight stays compared with a year before.

2.3 Inflation accelerated in December

Inflation reached +1.4 percent in December 2016 (November +1.3 percent), according to calculations by Statistics Austria, its highest level since November 2014 (+1.7 percent). This upward trend largely stemmed from increases in the "housing, water, energy" expenditure category: rentals for housing rose by 4.3 percent, apartment maintenance costs by 1.2 percent on average; heating oil prices, after falling by 2.4 percent in November, picked up by 15.3 percent in December, thereby having a noticeable impact on price developments of household energy overall. Excluding price increases for mineral oil products, inflation would have stood at 1.2 percent.

The development of the Harmonised Index of Consumer Prices (HICP) suggests even greater price dynamics (December +1.6 percent, November +1.5 percent). It shows marked price increases in the "restaurants and hotels" expenditure group as well as for fuels and repairs of means of private transport, which resulted in a much sharper rise in the HICP compared with the CPI. Price declines for airline tickets, by contrast, had a downward impact.

The average inflation rate for 2016 as measured by the CPI was +0.9 percent, much lower than in the years from 2010 to 2014. The upward drift in prices flattened from +1.2 percent in January to +0.5 percent in April (lowest reading of the year), then remained at +0.6 percent until August, and subsequently rose steadily to +1.4 percent in December (highest reading of the year).

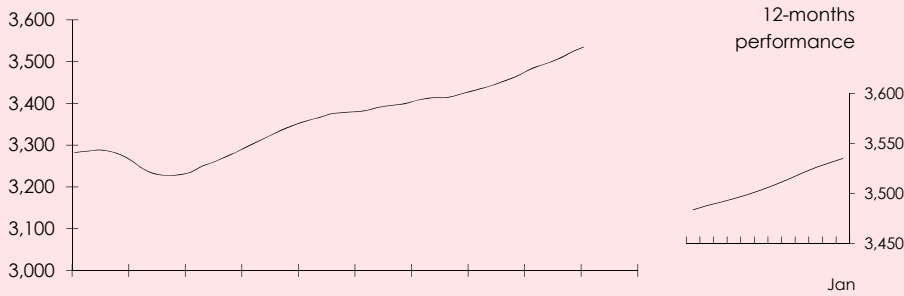
In 2016, notably the prices in the "restaurants and hotels" component had a large upward impact on inflation (+3.3 percent), with price increases registered in particular for services related to the provision of food and drink (+3.2 percent) and accommodation services (+3.6 percent). The "transport" expenditure category had the biggest downward impact (-1.8 percent). The decline in fuel prices determined price dynamics in this category at the beginning of 2016. By contrast, repairs of means of private transport became considerably more expensive.

Inflation dynamics have recently been determined by a persistent sharp rise in rentals for housing, costs of apartment maintenance and services related to the provision of food and drink.

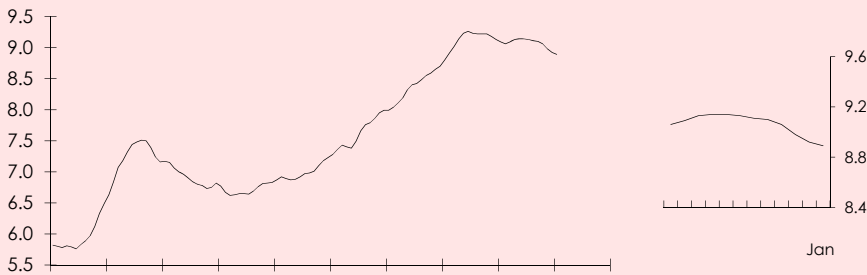
CPI inflation for 2016 averaged +0.9 percent.

Figure 3: Key economic indicators

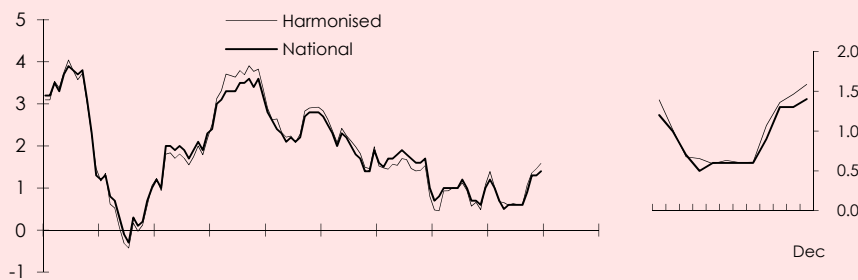
Persons in active dependent employment¹, (1,000), seasonally adjusted



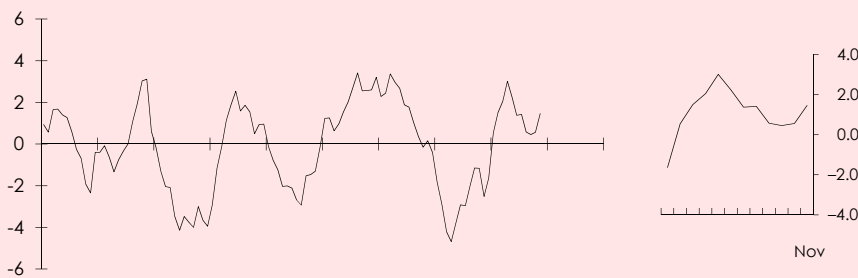
Unemployment rate, traditional Austrian method², seasonally adjusted



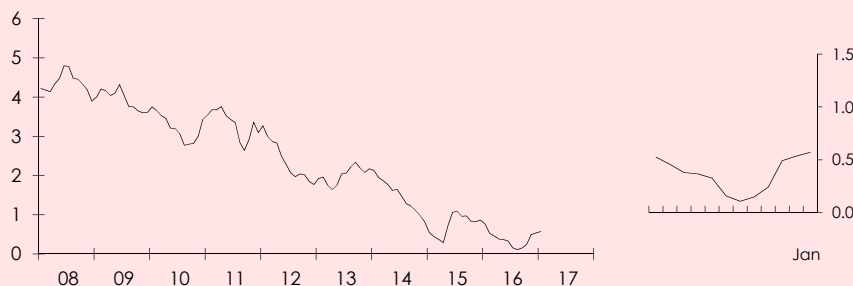
Consumer prices, year-to-year percentage changes



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.

2.4 Labour market developments determined by sharp growth in labour supply

Employment growth proceeded in 2016 (2014 +0.7 percent, 2015 +1.0 percent, 2016 +1.6 percent), with the number of persons in active dependent employment rising by around 54,000 compared with a year before. The increase continued in January 2017 (+4,500, seasonally adjusted, compared with a month before; expected year-on-year increase +58,000 or +1.7 percent).

The number of persons unemployed (excluding persons in training) fell slightly in January compared with a year before (-2,700, November 2016 -3,600, December -7,100, compared with a year before). The last-recorded seasonally adjusted number of persons registered as unemployed was about 353,000. The seasonally adjusted unemployment rate stood at 8.9 percent.

The leading indicators for the labour market point to continued positive developments in the demand for labour. For instance, the labour requirements of industrial firms may grow further in the coming months. This is suggested by the high level of the sub-indicator for employment of the Bank Austria Purchasing Managers' Index. The number of vacant jobs registered with the Public Employment Service is also on the rise, owing to the pick-up in economic activity. But since the brisk growth in labour supply continues unabated, unemployment is declining only little, despite the favourable economic development.

Employment dynamics strengthened further last year, employment of Austrian citizens rose markedly.