

Christian Glocker

# Recessionary Tendencies Seen in Austria at the End of 2014

## Business Cycle Report of December 2014

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Austria's real GDP contracted by 0.1 percent in the third quarter compared with the previous quarter. As a result of this development and consistent with the dismal picture painted by the leading indicators for the fourth quarter of 2014, a technical recession lies within the realms of possibility. So far there is no evidence of a subsequent recovery, but the Austrian economy should regain some momentum on the back of the euro weakness and the continued decline in commodity prices.

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The Austrian economy currently lacks expansionary impetus both domestically and from abroad. Household consumption is stagnating, and Austrian exports have been declining markedly quarter on quarter since the second quarter of 2014. Weak order books, alongside falling final domestic and foreign demand and a gloomy economic climate, have made firms more cautious in their investment activity. Against this background, real output of the Austrian economy for the first time since the beginning of 2013 declined in quarterly terms in the third quarter of 2014. Hence the economic downturn in Austria has once again deepened, following already highly lacklustre activity in the first half of the year. Numerous sentiment indicators had already suggested the slowdown. The persistently unfavourable picture painted by the leading indicators implies that economic activity will continue to lose momentum in the fourth quarter of 2014 and beyond. Given currently flat medium-term growth, even minor economic fluctuations cause a shrinking of the economy. Hence a technical recession cannot be ruled out.

The global economy continued to expand modestly in the third quarter of 2014, with strong divergence across regions; it thus remained on the growth path it had embarked on in the previous quarter. In the euro area, the economic slack that had become apparent already in the spring persisted. The continuing unsatisfactory cyclical trend in the euro area was largely determined by persistently weak growth in Italy and the cyclical slowdown in Germany. Cyprus and Austria were the only countries, apart from Italy, where GDP contracted in the third quarter. Meanwhile, unemployment has begun to decline in almost all EU countries, notwithstanding the sluggishness of economic activity. Exceptions include France, Italy and Austria.

The subdued momentum of the Austrian economy so far has not stood in the way of an increase in employment on the one hand, and continuing strong labour supply

growth on the other. The number of people in dependent active employment has risen continuously throughout the year, and is estimated to have exceeded the year-earlier level by almost 14,000 in November. 332,000 people were registered as unemployed with the Public Employment Service Austria (AMS) in November. Hence the seasonally adjusted unemployment rate stood at 8.6 percent.

In line with the European trend, prices are now moving sideways overall also in Austria. The inflation rate was 1.6 percent in October 2014, unchanged from September, according to Statistics Austria. Inflationary dynamics are therefore considerably stronger in Austria than on euro area average, despite the weaker economic momentum. Inflation was once again driven by rent developments.

## 1. Global economy expanding modestly in third quarter

The global economy is likely to have continued to expand modestly, with substantial divergence across regions, in the third quarter of 2014. Hence it remains on the growth path it embarked on already in the second quarter after overcoming a number of special negative effects early in the year. The main impetus for growth stems from a few industrialised countries whose economies are increasingly benefiting from declining private sector deleveraging, a loose fiscal policy and an ongoing accommodative monetary policy stance. Conversely, the economic expansion potential in several emerging market economies continues to be limited by structural weaknesses such as infrastructure shortages, product and labour market rigidities, internal and external trade imbalances as well as more restrictive financial conditions. Geopolitical risks, especially the conflict between Ukraine and Russia as well as tensions in major petroleum producing countries, have had a rather limited impact on crude oil prices and the global economy until now.

Current sentiment indicators point to a slowdown in global economic growth at the beginning of the fourth quarter, with apparently increased divergence across countries. The global Manufacturing Purchasing Managers' Index (PMI) fell once again in November, but still remained above the threshold indicating growth. The decline was broad-based across advanced and emerging market economies, and was particularly pronounced in Japan and Brazil. Meanwhile, the OECD leading indicators, designed to anticipate cyclical turning points, in September pointed to a varying outlook for major economies; according to this outlook, the expansion is set to slow in Japan, and economic activity will remain stable in the USA and in China.

## 2. US economy growing vigorously

Among the big advanced economies, the USA as expected was not able to maintain the rapid expansion influenced by offsetting effects that had been witnessed in the second quarter, but it did record comparatively high quarter-on-quarter growth in real value added (+1.0 percent) in the third quarter.

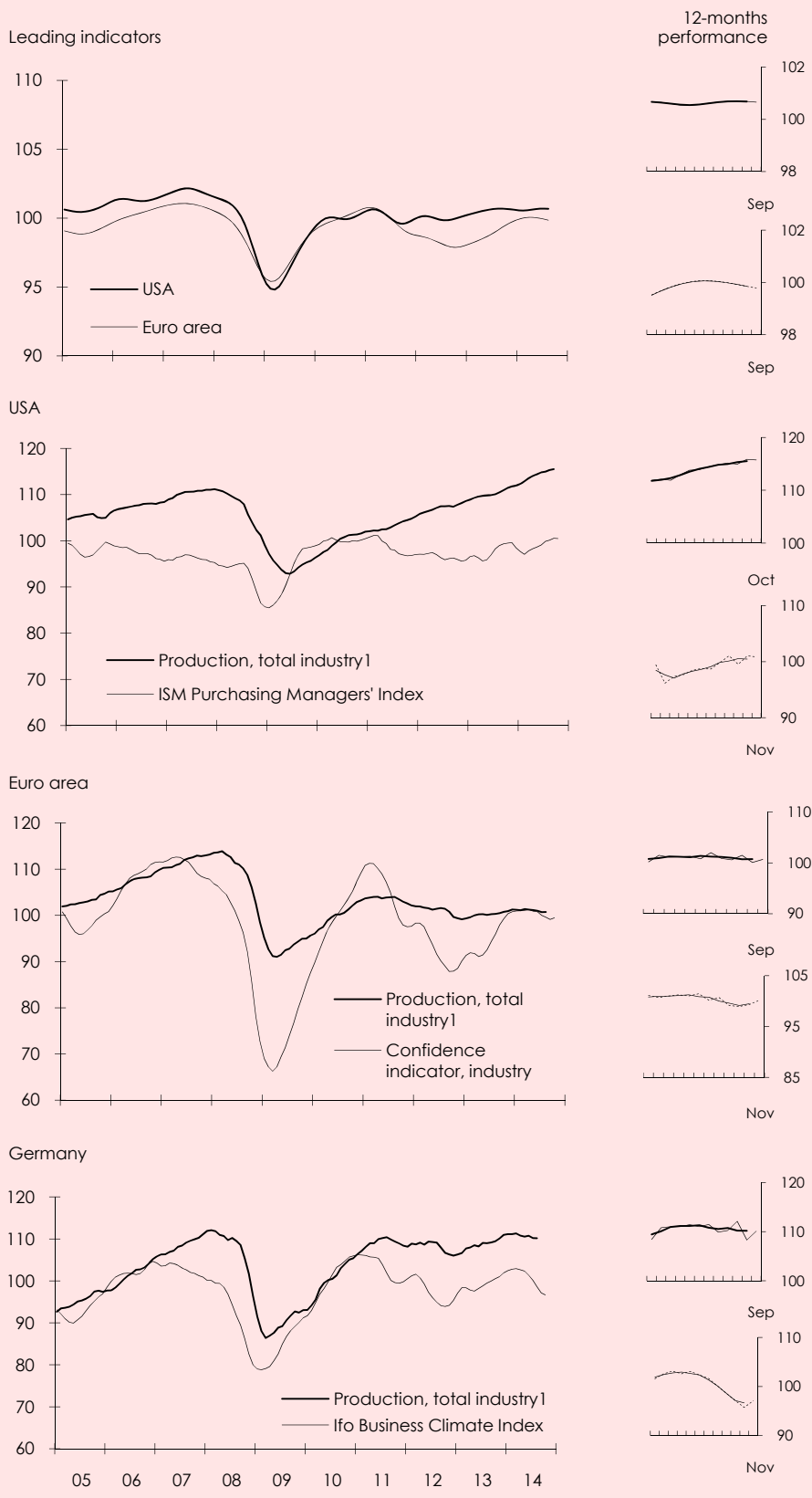
As in the previous quarter, this continued favourable development was due to specific effects; however, the expansionary forces on the outlay side have slightly shifted. Given a marked rise in exports in tandem with a decline in imports, net trade contributed substantially to aggregate output growth in the third quarter. Another factor was an unexpectedly brisk expansion of government demand, especially for military purposes.

The underlying momentum of economic activity remains modest. The expansion of aggregate production was nevertheless sufficient to cause a decline in the unemployment rate by more than 4 percentage points over a period of five years to 5.8 percent in October 2014. Owing to the progress seen in the labour market, the Fed recently decided to end its asset purchase program.

*In the USA, the economic recovery has strengthened in the last six months. The expansion has been driven – in the context of continuously rising exports and declining imports – by a reversal in the contribution of net exports and by the ongoing strength of domestic demand.*

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.

### 3. Economic slack persists in euro area

The economic slack that had become apparent in the euro area already in the spring persisted in the third quarter. Following the general stagnation in the second quarter, real GDP rose only modestly at a seasonally adjusted quarter-on-quarter rate of +0.2 percent. Compared with a year before, the economy expanded by 0.8 percent. Hence the acceleration in economic activity expected by mid-year failed to materialise.

The continued unsatisfactory development in the euro area was largely determined by ongoing weak growth in Italy, Austria's second most important foreign trade partner, and a cyclical slowdown witnessed over the year in Germany. In Italy, for instance, real GDP contracted again on a quarter-on-quarter basis in the third quarter, while in Germany it grew marginally following a slight decline. In France, economic output expanded in the second quarter after a small contraction in the summer, although here, too, the basic trend remained weak. Cyprus and Austria were the only countries, apart from Italy, to register a quarter-on-quarter contraction in GDP. By contrast, brisk economic growth continued in Spain, Portugal and Slovakia.

The weak growth in the third quarter was largely attributable to industry, in particular to the decline in the production of consumer goods and intermediates. In October, capacity utilisation in the manufacturing sector remained below its long-term average.

Meanwhile, the unemployment rate has been falling in almost all euro countries; exceptions include France, Italy and Austria. In the three peripheral countries Ireland, Spain and Portugal, the unemployment rate declined even very markedly from very high levels in 2013 and 2014, owing on the one hand to the fact that the economic recovery got off the ground but was accompanied by low productivity growth, and, on the other hand, to the shrinking of the working-age population and the declining labour force participation (discouragement, emigration and/or lack of immigration).

ECB monetary policy reacted also in November to the subdued inflation prospects, the moderating growth momentum and the continued sluggish monetary and credit dynamics. Key interest rates, for instance, were kept unchanged at low levels at the beginning of November. The ECB has been purchasing covered bonds within the framework of the new monetary policy expansion program already since October. It will also soon start purchasing asset-backed securities. These programs should have a considerable impact on the Eurosystem's balance sheet and should slowly bring it up again to the dimensions it had at the beginning of 2012 – the ECB's balance sheet has been declining continuously since the beginning of 2012, in spite of expansionary monetary policy efforts.

Signs of a continuation of the sluggish activity in the euro area have begun to emerge in the fourth quarter of 2014. In October, the Composite Purchasing Managers' Index remained above the threshold indicating growth. Besides, the industrial confidence indicator marginally improved in October, following a decline that had lasted four months. This was largely owing to improved production expectations and a more optimistic assessment of order books.

*Real value added increased in the euro area at a quarter-on-quarter rate of 0.2 percent in the third quarter. However, there exist substantial differences in economic performance across countries.*

*The ECB continues to use unconventional instruments to preserve the functioning of the monetary policy transmission mechanism.*

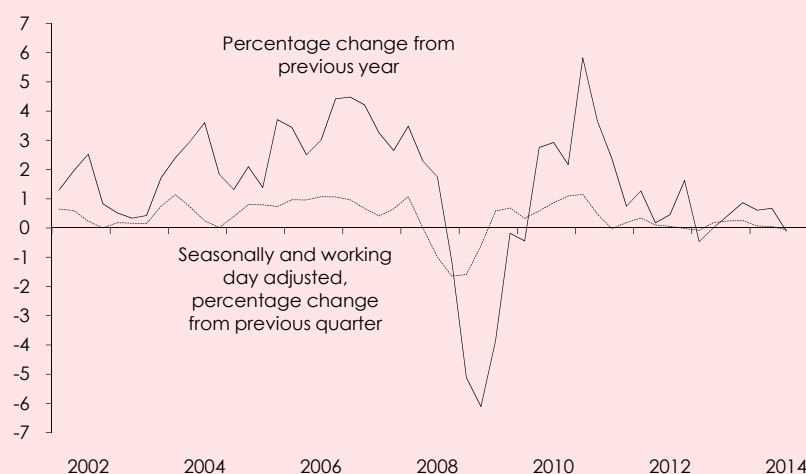
*Leading indicators point to slow economic activity over the medium term.*

### 4. Further weakening of economic activity in Austria

The Austrian economy contracted in the third quarter, compared with the previous quarter (Table 1, Figure 2). Hence the economic downturn in Austria deepened further, following already highly lacklustre activity in the first half of the year. Numerous sentiment indicators had already suggested a slowdown. The unfavourable picture painted by the leading indicators implies that the weakness will persist in the fourth quarter of 2014 and beyond.

*Given the disappointing development of the Austrian economy in the third quarter, in line with the dismal picture painted by the leading indicators for the fourth quarter of 2014, a technical recession lies within the realms of possibility.*

Figure 2: Growth of real GDP



Source: WIFO.

Table 1: Quarterly national accounts

			Second quarter	2013 Third quarter	Fourth quarter	First quarter	2014 Second quarter	Third quarter
Percentage changes from previous quarter								
<i>Adjusted for seasonal and working day effects, volume</i>								
Final consumption expenditure			+ 0.1	+ 0.1	+ 0.1	+ 0.1	+ 0.1	+ 0.2
Households <sup>1</sup>			+ 0.1	+ 0.1	+ 0.1	+ 0.1	+ 0.1	+ 0.1
General government			+ 0.2	+ 0.2	+ 0.2	+ 0.2	+ 0.2	+ 0.2
Gross capital formation			- 1.0	+ 0.8	+ 0.4	- 0.7	+ 0.6	+ 1.6
Gross fixed capital formation			+ 0.1	+ 0.5	+ 0.2	+ 0.5	- 0.3	- 0.8
Machinery and equipment			+ 0.8	+ 0.6	- 0.1	+ 1.3	- 0.1	- 1.0
Construction			- 0.3	+ 0.8	+ 0.6	+ 0.3	- 0.5	- 1.0
Exports, goods and services			+ 0.9	- 0.1	+ 0.1	+ 0.5	- 0.4	- 0.8
Goods			+ 1.1	+ 0.0	+ 0.2	+ 1.1	+ 0.1	- 0.9
Services			+ 0.5	- 0.3	- 0.4	- 1.1	- 1.7	- 0.7
Imports, goods and services			+ 0.4	+ 1.0	+ 0.1	+ 0.0	+ 0.4	+ 0.1
Goods			+ 0.2	+ 1.0	- 0.1	- 0.3	+ 0.3	- 0.1
Services			+ 0.9	+ 0.9	+ 1.0	+ 1.1	+ 0.8	+ 0.7
Gross domestic product			+ 0.2	+ 0.2	+ 0.3	+ 0.1	+ 0.1	- 0.1
Manufacturing			+ 1.1	+ 0.5	+ 0.2	+ 0.1	+ 0.4	- 0.4
	2012	2013	Second quarter	2013 Third quarter	Fourth quarter	First quarter	2014 Second quarter	Third quarter
Percentage changes from previous year								
<i>Volume, chained prices</i>								
Final consumption expenditure	+ 0.6	+ 0.1	- 0.7	+ 0.4	+ 0.8	- 0.2	+ 0.6	+ 0.7
Households <sup>1</sup>	+ 0.6	- 0.1	- 1.1	+ 0.1	+ 0.7	+ 0.0	+ 0.3	+ 0.4
General government	+ 0.4	+ 0.7	+ 0.2	+ 1.3	+ 1.0	- 0.7	+ 1.3	+ 1.5
Gross capital formation	- 0.5	- 4.4	- 4.4	- 1.1	- 2.9	+ 4.8	+ 1.8	- 2.3
Gross fixed capital formation	+ 0.5	- 1.5	- 2.5	- 0.1	- 1.4	+ 3.9	+ 2.0	- 1.3
Machinery and equipment	- 0.6	- 1.5	- 2.3	+ 4.0	- 2.8	+ 5.1	+ 4.5	- 0.6
Construction	+ 1.2	- 2.2	- 4.0	- 2.2	- 0.8	+ 5.8	+ 1.6	- 2.1
Exports, goods and services	+ 1.3	+ 1.4	+ 1.9	+ 0.2	+ 1.8	+ 0.8	+ 0.2	- 0.9
Goods	+ 1.1	+ 0.4	+ 1.4	- 1.1	+ 2.0	+ 2.5	+ 1.7	+ 0.2
Services	+ 2.0	+ 4.3	+ 3.5	+ 4.0	+ 1.5	- 3.2	- 3.9	- 3.6
Imports, goods and services	+ 0.7	- 0.3	- 1.1	+ 0.8	+ 1.2	+ 2.3	+ 2.0	- 0.5
Goods	- 0.2	- 1.3	- 1.8	- 0.0	+ 0.4	+ 1.7	+ 1.3	- 1.9
Services	+ 4.5	+ 3.6	+ 1.6	+ 3.7	+ 3.8	+ 4.9	+ 4.3	+ 4.0
Gross domestic product	+ 0.9	+ 0.2	+ 0.0	+ 0.4	+ 0.9	+ 0.6	+ 0.7	- 0.1
Manufacturing	+ 1.2	+ 0.7	+ 1.8	+ 1.2	+ 1.8	+ 1.2	+ 0.1	- 1.0
Gross domestic product, value	+ 2.8	+ 1.7	+ 1.6	+ 1.5	+ 2.1	+ 2.2	+ 2.5	+ 1.7

Source: WIFO. - <sup>1</sup> Including private non-profit institutions serving households.

The slowdown originated in the production sector. Since the beginning of the year, new industrial orders have been flat or even declining, and business sentiment has been deteriorating continuously since March. Expecting a worsening of the business trend, industry has been modestly cutting production already since the summer. The construction sector, after weather-related fluctuations in the first half of the year, was not able to continue from the higher level of activities seen in the previous year. Business in the services sectors followed a similar pattern.

Foreign sales of Austrian firms were considerably lower in the third quarter of 2014 than in the spring. This is consistent with the weak production data and the worsening of export expectations witnessed since the beginning of the year. The decline in merchandise exports in the course of the third quarter of 2014 reflected to a similar extent a decline in exports to various eastern European countries, notably Russia and Ukraine, as well as to South American countries. By contrast, exports to neighbouring countries increased, with the exception of those to Italy, Austria's second most important trading partner. Exports to Asia also expanded, with notably exports to China growing briskly in 2014. Exports to the USA rose again noticeably. Sales in OPEC countries also picked up vigorously.

The decline in imports reflects both the sluggishness of domestic activity and the weakness in exports. Notably firms' ongoing reluctance to invest at home became apparent here. The recovery in gross fixed investment observed in the second half of 2013 has not continued in 2014. Firms do not expect an increase in demand that would require an expansion of capacity. Hence fixed investment is limited primarily to replacement and modernisation projects. The respective short-term indicators also confirm firms' ongoing cautious investment behaviour.

#### **4.1 Picture painted by indicators remains dismal**

Economic activity is set to remain subdued, according to the picture painted by leading indicators: In November, WIFO's Business Cycle Survey showed no substantial changes from the previous month. Assessments of the current situation have recently deteriorated, while the outlook for the coming months has slightly improved. The Current Situation Index for the economy as a whole stood at -1.3 points in November, clearly below the level a month earlier and the average of previous years. As the results for the individual sectors show, this decline largely reflected unfavourable developments in the services sector, while the current situation index slightly improved in construction and in the manufacturing sector.

Economic expectations brightened somewhat in November compared with the previous month, with the business expectations index rising for the second straight time. The indicator rose marginally in manufacturing as well as in construction – in the latter case remaining in pessimistic territory. However, the improvement was within the usual fluctuation margin of short-term changes, and can therefore not be interpreted as a trend reversal.

The Bank Austria Purchasing Managers' Index also suggests that economic activity will remain weak. While increasing slightly recently, it remained noticeably below the threshold indicating expansion.

Following the continuous downward movement in recent months, WIFO's Leading Indicator is once again pointing downward. The downward trend has weakened considerably, however, and is likely to come to a halt. Strong divergences exist between the pictures painted by the individual sub-indicators, with both domestic and foreign components providing mixed signals.

#### **4.2 Inflationary pressures remain stronger than in euro area as a whole and in Germany**

Inflation in Austria (as measured by the HICP) has settled down at around 1½ percent in recent months. Falling energy prices (October 2014 -1.8 percent year on year, as measured by the HICP) did have a dampening effect on inflation, but the sharper increase in services prices (+2.8 percent, euro area +1.2 percent) more than offset this effect. Therefore Austria (+1.4 percent; CPI inflation +1.6 percent) has the highest inflation rate in the euro area (+0.4 percent, Germany +0.7 percent). Three

quarters of the inflation differential of +1.0 percentage point vis-à-vis the euro area average (or +0.7 percentage point vis-à-vis Germany, respectively) can be attributed to sharper price increases for services (cafeterias, restaurants and hotels, communication, housing, and medical services). In addition, food prices contributed around +0.2 percentage point and energy prices around 0.1 percentage point to the inflation differential vis-à-vis the euro area average (+0.1 percentage point each vis-à-vis Germany).

*Inflation in Austria (+1.4 percent as measured by the HICP) is considerably higher than the euro area average (+0.4 percent), despite the weaker economic momentum.*

Figure 3: Results from the WIFO Business Cycle Survey

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



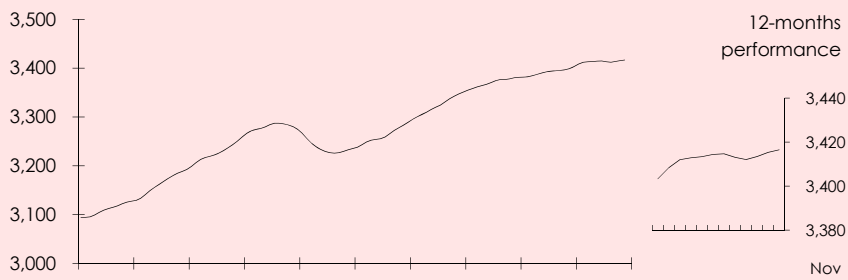
Source: WIFO Business Cycle Survey. Data refer to index points (percentage points) between +100 and -100. Values above 0 imply positive expectations, values below 0 indicate negative expectations.

### 4.3 Subdued development in tourism industry

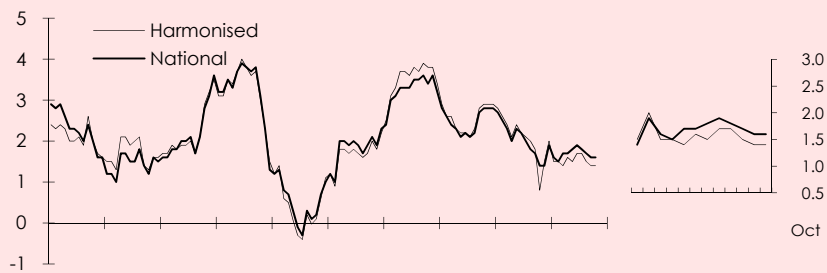
In the 2014 summer season, the Austrian tourism industry posted a sales increase of 1.1 percent compared with the same season a year before, according to provisional calculations. In seasonally adjusted terms, sales fell slightly, while real expenditure per night spent declined somewhat more noticeably (-1.6 percent). The number of nights spent in the period from May to October 2014 totalled 67.2 million, a slight increase from the 2013 summer season. The positive overall development is largely due to the strong increase in the number of nights tourists spent in Vienna (+5.9 percent). The demand in the rest of Austria remained almost flat (+0.4 percent). Besides, the number of nights spent by international guests grew more briskly (+1.3 percent) than the demand from residents (+0.4 percent).



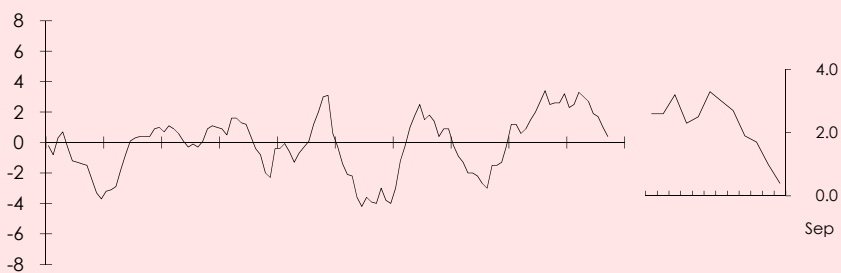
Figure 4: Key economic indicators

Persons in active dependent employment<sup>1</sup>, (1,000), seasonally adjustedUnemployment rate, traditional Austrian method<sup>2</sup>, 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. – <sup>1</sup> Excluding parental leave, military service, and unemployed persons in training. – <sup>2</sup> As a percentage of total labour force excluding self employed, according to Public Employment Service.



In the summer of 2014, the demand for the destination Austria varied across international source markets: a sharp increase was registered in the number of nights spent by guests from the USA (+10.0 percent), Poland (+8.7 percent), Hungary (+7.3 percent), the Czech Republic (+5.1 percent) and Romania (+3.5 percent). The demand from the UK (+3.0 percent), Belgium (+2.3 percent), Switzerland (+1.6 percent) and Sweden (+1.4 percent) was also above the international average (+1.0 percent), while the demand from Germany and Denmark (+0.5 percent each) barely increased. A small decline was recorded in the number of nights spent by guests from the Netherlands (-0.5 percent) and France (-1.1 percent), whereas a sharper drop was registered in the Italian (-3.5 percent) and the Russian market (-11.3 percent).

#### 4.4 Developments in Austrian labour market remain ambivalent

The subdued economic activity so far has impaired neither the expansion of employment nor the continued sharp increase in the labour supply. The number of people in dependent active employment continued to rise steadily in 2014, and is estimated to have exceeded the year-earlier level by almost 14,000 in November. At the same time the number of unemployed people rose by just under 29,900, compared with a year before. This strong increase in the labour supply continues to be driven largely by immigration. The sector profile barely changed compared with the spring: employment growth was comparatively strong in the "other business services", health and social services, and restaurant services sectors. Manufacturing, construction, and the financial and insurance services sector, by contrast, did not contribute to the expansion of employment. The most recent seasonally adjusted unemployment rate was 8.6 percent.

*The labour supply continues to grow: in addition to the expansion of employment, there is also a substantial increase in unemployment.*