

Christian Glocker

Domestic Demand Supports Economic Activity in Austria

Business Cycle Report of August 2019

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In the second quarter of 2019, Austrian GDP grew by 0.3 percent compared to the previous period (after +0.4 percent in the first quarter of 2019 and +0.5 percent in the fourth quarter of 2018). Although the expansion of previous years continued, it has slowed continuously since the beginning of 2018. The positive development of the real economy continues to be reflected in the labour market in the form of an increase in employment and a decline in unemployment. Inflation has recently slackened.

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The global economy is currently in a phase of moderate growth. Both industrialised and emerging countries are contributing to the expansion. Although growth slowed noticeably in the second quarter of 2019 according to information available to date, the forces for a continuation of expansion are likely to remain intact. The picture of the leading indicators points to a continuation of the moderate expansion. Risk factors, however, are the uncertainty regarding economic policy-induced disruptions to global trade flows and geopolitical tensions.

According to the current WIFO Flash Estimate, the GDP of the Austrian economy grew by 0.3 percent in the second quarter of 2019 compared to the previous quarter (trend-cycle data). Hence the expansion continued but weakened further in line with the international economy. Growth was primarily driven by domestic demand, mainly by consumption expenditure; gross fixed capital formation also expanded, albeit to a lesser extent than in the previous quarters. Concerning foreign demand, the pace of growth also slowed recently, while at the same time the industrial sector lost momentum.

The picture for the leading indicators recently stabilised somewhat following a prolonged phase of clouding. On the whole, they continue to give an optimistic outlook, although they vary strongly across the sectors: industry is predominantly pessimistic, construction and service companies remain confident.

According to the harmonised CPI, the inflation rate was 1.6 percent in June 2019, 0.1 percentage point below the comparable figure for the previous month. Hence, price inflation in Austria was higher than the euro area average (1.3 percent) and corresponded to that of the EU 28 as a whole (1.6 percent). According to the national

definition, the inflation rate was also 1.6 percent. Price increases for housing, water, energy as well as for restaurants and hotels still dominate the inflation dynamics and contribute most to the increase in consumer prices.

Sustained economic growth continues to support employment growth and the decline in unemployment. According to preliminary estimates, the number of persons in active dependent employment in July was 59,000 higher than in the previous year (+1.6 percent), but seasonally adjusted it stagnated, compared to the previous month. The number of seasonally adjusted vacancies no longer increases significantly. In July, the Public Employment Service Austria (AMS) registered 10,800 fewer unemployed than in the previous year (-3.8 percent), including persons in training, the decline was 15,400 (-4.5 percent). According to national definitions, the seasonally adjusted unemployment rate remained at estimated 7.4 percent in July.

1. Growth slowed worldwide in the first half of 2019

Worldwide, economic signals continue to be mixed. Overall, the growth momentum in the first half of the year is likely to have been lower than in the previous year, with trade and industry in particular expanding at a slower pace. In Europe, the expansion of the economy slowed down more strongly, while in Japan a strong increase was recorded in the first quarter of 2019, compared to the previous quarter. The picture of the leading indicators in Japan remains positive, so expansion is likely to have continued in the second quarter. In the USA, the economy lost some momentum in the second quarter of 2019, but growth in the first half of the year was similarly strong as in the same period of the previous year.

In the group of emerging economies, China continued its high growth by international comparison in the first half of the year. Data for the second quarter are not yet available for the majority of the other emerging markets, but leading indicators point to a weakening in this group of countries as a whole. The economies of Russia, Argentina and Brazil contracted already in the first quarter.

Overall, the leading indicators point to a marked slowdown in the expansion of the global economy in the coming quarters. The global Purchasing Managers' Index (J. P. Morgan Global Composite PMI, based on Markit data), for example, remains in a range that points to expansion, despite a steady weakening since the beginning of 2018. The sub-indicators from this show a broad spread of the expected expansion across the sectors – the weakness of industry is likely to continue, while the service sector, on the other hand, will continue to grow strongly.

1.1 Robust growth in the USA

In the USA, the economy maintained its recent momentum in the first half of 2019. Real GDP grew by 0.8 percent in the first quarter of 2019 and by 0.5 percent in the second quarter, compared with the previous quarter, after switching off seasonal effects. In the previous year the growth rates for the first and second quarters were 0.6 and 0.9 percent, respectively. Although overall economic output in the second quarter was slightly weaker than in the previous quarter, the growth rate of private consumption expenditure increased significantly. After the tax relief for private households came into force in the previous year and thanks to the still very favourable conditions on the labour market, the general conditions remain favourable and private consumption should therefore remain a pillar of economic growth. Investment, on the other hand, presents a mixed picture – after a strong increase in the first quarter, it fell in the second quarter.

Conditions on the labour market remain tight: the labour force participation rate continued to rise and the unemployment rate of 3.7 percent in July was still well below the Fed's estimate of the natural rate, which has been reduced in recent years from 5½ percent to now 4¼ percent. In April, the unemployment rate reached its lowest level since the beginning of 1970. In this environment, wage growth is also increasing more strongly now. From the point of view of companies, this is increasing the pressure on costs, which is reflected in a higher rise in prices. In June, the CPI rose by 1.6 percent year-on-year, while the core inflation rate rose more strongly by +2.1 percent. Against

The global economy developed heterogeneously in the first half of the year: in Europe and Latin America in particular, the economy weakened; in China, but also in the USA, overall economic development was significantly better.

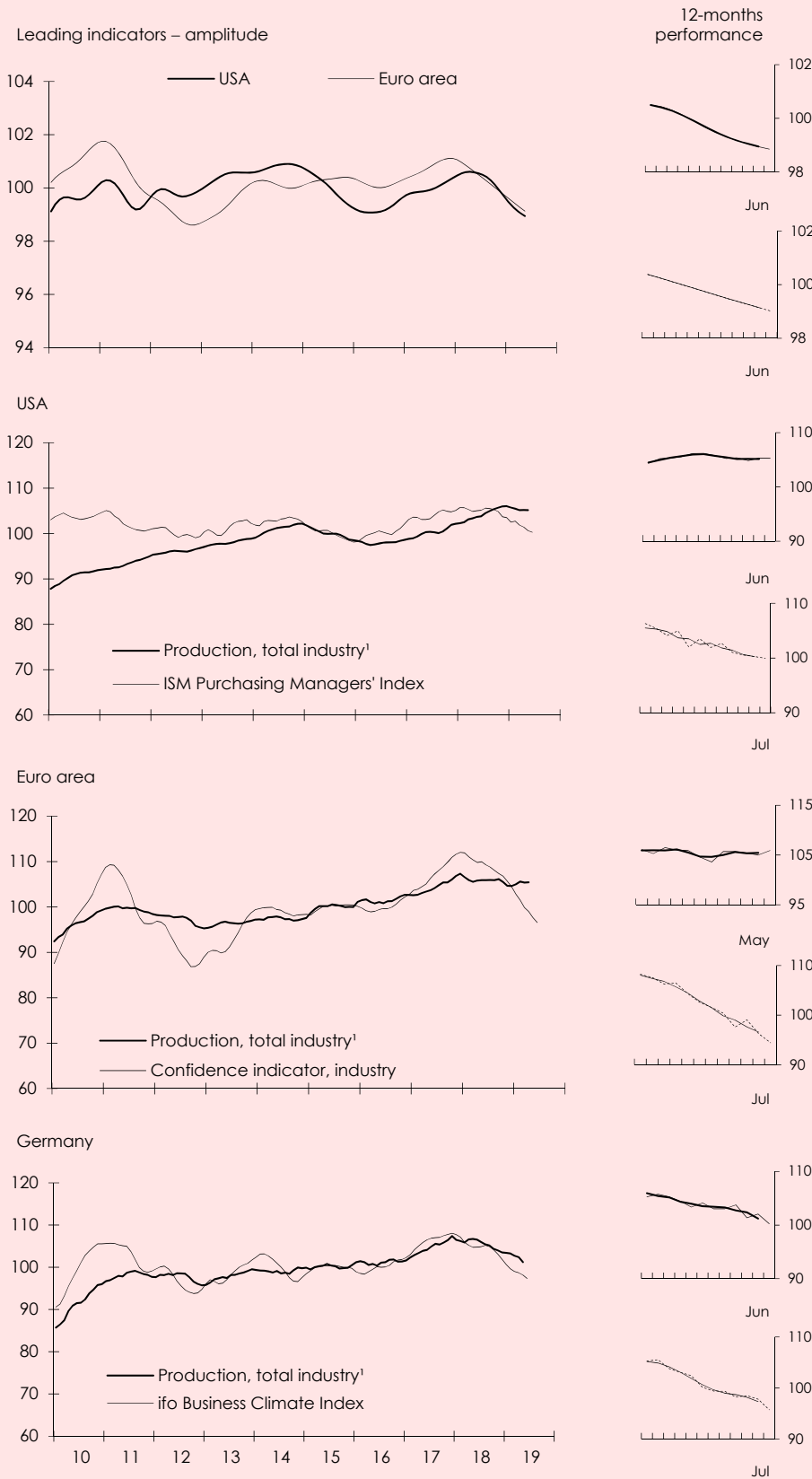
In the USA, the unemployment rate fell in April to its lowest level for almost 50 years. The robust economy is expected to continue in the coming months.

In July 2019, the US central bank decided to lower the key interest rate for the first time again, thus putting an end to the tightening of monetary policy in the form of interest rate hikes that had begun at the end of 2015.

this backdrop, the Fed's recent decision to lower the key interest rate also signals a change in its previous monetary policy orientation.

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.

1.2 Moderate expansion in the euro area

Real GDP in the euro area rose by 0.2 percent in the second quarter of 2019 compared with the previous quarter, after growth in the first quarter was significantly higher at +0.4 percent. The cyclical slowdown had already been indicated by the leading indicators; in addition, the expiry of one-off effects is likely to have had an effect here. Thus, the original Brexit date stimulated many companies to increase inventories in the first quarter; these inventories tended to be reduced in the second quarter. Due to the mild winter, construction output is likely to have developed at an above-average rate, especially in the first quarter.

The economic slowdown in the euro area is widely spread across the countries. To the extent that data are already available for the second quarter, it now also affected Spain in addition to France, Belgium, Austria and Italy. No data are yet available for Germany for the second quarter, but economic output is likely to have been rather weak. On the one hand, important sentiment indicators continued to weaken during this period. On the other hand, industrial production declined again in the second quarter. In contrast, seasonally adjusted incoming orders have tended to rise again since March, although this is limited to bulk orders outside the euro area.

Recent survey information points to a continuation of this trend. The Economic Sentiment Indicator (ESI) published by the European Commission declined again in July for both the euro area and the EU as a whole. In the euro area, this was due to the decline in confidence indicators in manufacturing, services, retail trade and construction, while the consumer confidence indicator rose slightly. The development of sector indicators at the EU average was broadly in line with that of the euro area. Among the five largest economies in the euro area, the ESI increased in the Netherlands, Italy and Spain, while it fell markedly in Germany and remained unchanged in France. The decline of ESI at the EU average was mainly due to the development of confidence indicators outside the euro area: in the UK and Poland, the ESI last fell.

2. Economy loses momentum in Austria

According to the current WIFO Flash Estimate, GDP in Austria grew by 0.3 percent in the second quarter of 2019 compared to the previous quarter (trend-cycle data). Although the expansion continued, it weakened further in line with the international economy. Unadjusted GDP was 1.7 percent higher than in the previous year. Growth was driven by both domestic demand and foreign trade. Among the components of domestic demand, consumption expenditure made the highest (positive) contribution to growth. Private consumption expenditure (including non-profit institutions serving households) increased strongly in the second quarter (+0.5 percent), still supported by the favourable employment development and the increase in household incomes. At +0.3 percent, general government consumption expenditure expanded somewhat weaker. Overall, final consumption expenditure rose by 0.4 percent, similarly to the first quarter.

Corporate investment activity was again expanded, although the pace slowed here. Demand for gross fixed capital formation (machinery and equipment, construction and other investment) expanded by 0.5 percent (first quarter +0.8 percent). Foreign trade also slowed recently. Exports increased by 0.5 percent (after +0.9 percent in the first quarter). As the increase in imports was also lower (+0.4 percent after +0.7 percent), foreign trade again made a slightly positive contribution to overall economic growth.

Against this backdrop, the industrial sector also continued to lose momentum. Value added of manufacturing fell by 0.1 percent compared to the previous quarter (first quarter +0.1 percent). Construction, on the other hand, continued to record a vivid economic activity. Positive impulses also came from the service sectors.

Income development in the second quarter of 2019 was characterised by the increase in both capital income (gross operating surplus and gross mixed income +0.5 percent) and wage income (compensation of employees +1.0 percent). Wage incomes have repeatedly risen significantly faster than capital incomes because

Although economic growth in Austria continued in the second quarter of 2019, it weakened further. The expansion was further supported by the domestic demand and an increase in exports.

contractually determined wage incomes react with a considerable delay to economic impulses and therefore reflect the current economic slowdown even less than capital incomes.

2.1 Further sentiment deterioration in the manufacturing sectors

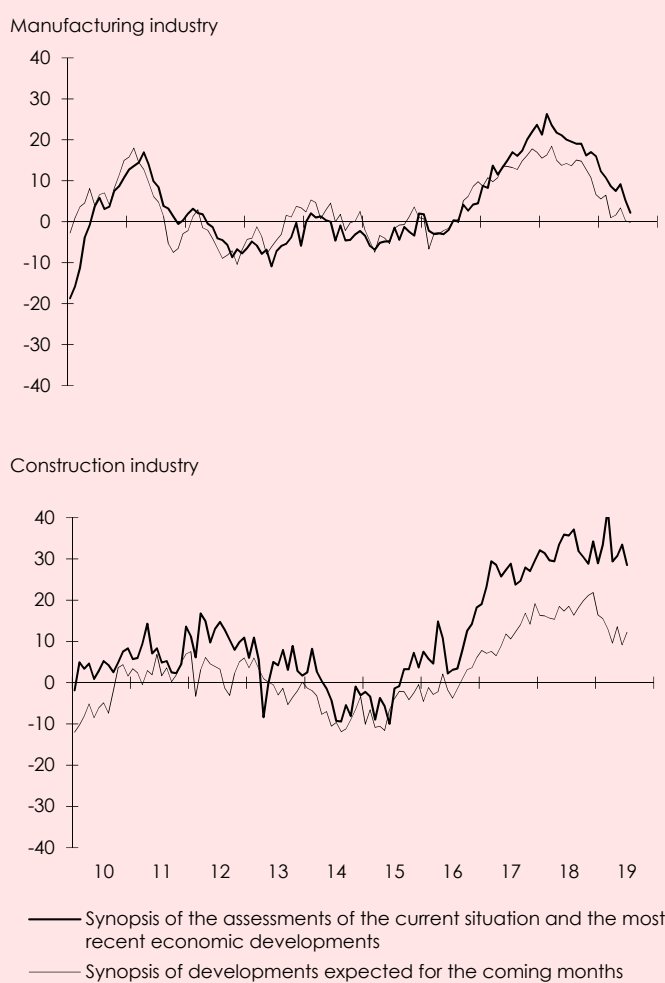
The results of the WIFO-Konjunkturtest (business cycle survey) of July 2019 show a sideways movement in economic assessments for the overall economy. However, there were marked differences between the sectors: while service providers assessed the economy more favourably and construction firms remained optimistic despite a downturn, the indicator for manufacturing fell further and is only just in positive territory.

The seasonally adjusted index of assessments of the current situation for the overall economy rises slightly in July and thus continued to indicate a confident assessment. In the service sectors, it increased significantly and thus signalled a vivid service economic activity. Concerning construction, however, the index declined, but remained in optimistic fields. In the manufacturing sector, which is important for the economy, the index of the current situation continued to decline and was only just in positive territory.

The picture of leading indicators has clouded over the past few months, but has recently stabilised to a large extent for the overall economy. All in all, they continue to provide an optimistic outlook.

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.

The index of business expectations remained almost unchanged in July. It picked up in the construction industry, but in the service sectors it declined slightly, but remained within the range of confident economic expectations. The expectation index also fell in the manufacturing sector and was in negative territory for the first time since August 2016.

The Bank Austria Purchasing Managers' Index fell to 47.0 points in July, thus falling below the growth threshold of 50 points for the fourth month in succession. This indicates a continuation of the unfavourable development of the Austrian industry.

2.2 Tourism continues to expand significantly

Based on initial estimates by WIFO, tourism revenues in May and June 2019 exceeded the previous year's level by 3.7 percent and amounted to a nominal 3.97 billion €. In real terms, the increase was 2.0 percent. In addition to the shift of public holidays compared to the previous year, other factors influenced the development in the individual months of the summer pre-season: demand in May 2019 was not only dampened by the late dates of Whitsun and Corpus Christi (2018 in May, 2019 in June), but also by the much too cool temperatures and heavy rainfall. In June the weather was midsummerly and relatively dry.

Nominal tourism sales increased particularly strongly in May and June in Vienna (+7.8 percent), Upper Austria (+6.9 percent), Salzburg (+4.6 percent) and Lower Austria (+4.4 percent). The number of overnight stays in commercial holiday apartments increased by 14.7 percent, while private holiday apartments also recorded above-average growth (+6.8 percent).

The demand for overnight stays in Austria is mainly determined by foreign guests: in the summer pre-season (May to June) 2019, their market share was 66.2 percent at 13.2 million. At +3.8 percent, this guest segment also developed much more dynamically than domestic demand (+2.8 percent). With the exception of the UK and France, growth was achieved in all important markets of origin.

2.3 Continued moderate price buoyancy

At +1.6 percent, the inflation rate in June 2019 was 0.1 percentage point lower than in the previous month. This was mainly due to the decline in fuel prices, which had risen in May. Housing, water and energy, as well as restaurants and hotel services, again proved to be massive price drivers: expenditure on housing, water and energy rose by an average of 3.1 percent year-on-year, contributing +0.61 percentage points to general inflation. In the restaurants and hotel services category, prices rose by an average of 3.1 percent, mainly due to higher prices for catering services. Without the categories "housing, water, energy" and "restaurants and hotel services", inflation would have been only 0.6 percent in June.

The Harmonised Index of Consumer Prices rose by 1.6 percent in June. Thus, the price increase in Austria was above the average for the euro area (+1.3 percent) and corresponded to that of the EU 28 as a whole (+1.6 percent). Inflation was relatively high in the Netherlands and Slovakia (both 2.7 percent), the Baltic countries (2.7 percent on average), Hungary (3.4 percent) and Romania (3.9 percent). On the other hand, price increases were only moderate in Denmark and Croatia (both 0.5 percent), Cyprus (0.3 percent) and Greece (0.2 percent).

2.4 Recovery in the labour market continues

Economic growth still favours the development of the domestic labour market. According to preliminary estimates, the number of persons in active dependent employment in July was 59,000 higher than in the previous year (+1.6 percent), but seasonally adjusted it stagnated compared with the previous month.

The number of unemployed registered with the Public Employment Service Austria (AMS) in July was 10,800 lower than in the previous year (-3.8 percent), including persons in training it was 15,400 lower (-4.5 percent). Seasonally adjusted unemployment fell by 0.2 percent compared to the previous month. The seasonally adjusted unemployment rate thus remained at 7.4 percent in July according to the national definition. Compared to the previous year, the decrease was 0.3 percentage points.

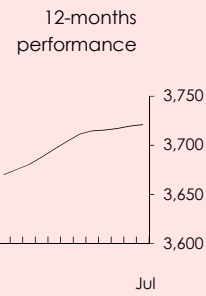
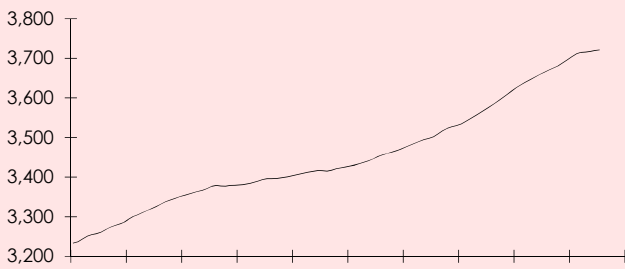
According to preliminary results, 19.95 million overnight stays were reported in the 2019 summer pre-season (May and June). In the first half of 2019 (January to June 2019), the number of overnight stays was 76.23 million, 0.7 percent higher than in the previous year.

Price increases in the categories "housing, water, energy" as well as "restaurants and hotel services" continued to drive inflation and once again contributed most to the rise in consumer prices.

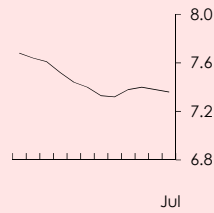
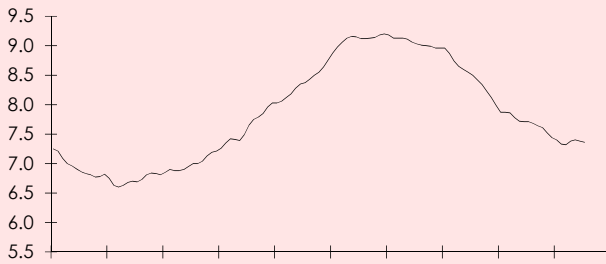
Companies continued to expand employment in June, while unemployment continued to fall.

Figure 3: Key economic indicators

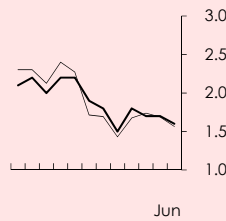
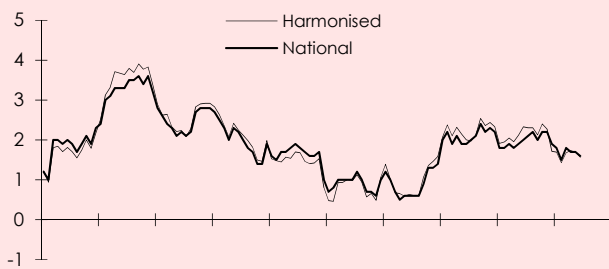
Persons in active dependent employment¹, 1,000s, seasonally adjusted



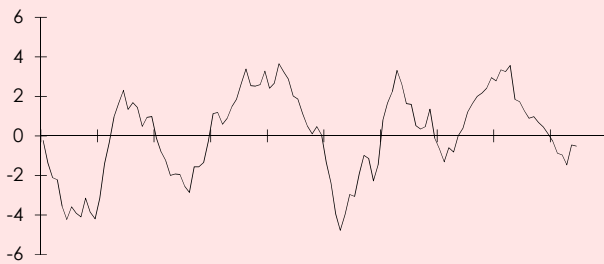
Unemployment rate, traditional Austrian method², seasonally adjusted



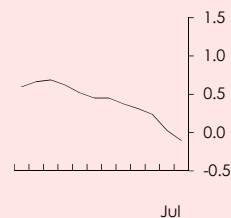
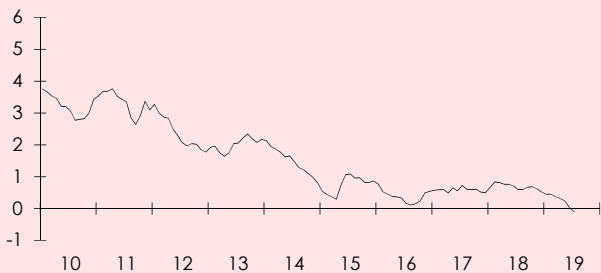
Consumer prices, year-to-year percentage changes



Real effective exchange rate, year-to-year percentage changes



10-year central government bonds (benchmark), percent



Source: Public Employment Service Austria, 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.