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Economic Recovery in Austria Modest at Beginning of 2014

Business Cycle Report of June 2014

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Real GDP in Austria expanded by 0.2 percent in the first quarter of 2014 compared with the previous quarter. The upturn did not accelerate further, but it did strengthen. Economic growth, which is buttressed by broad-based demand, is increasingly receiving stimulus from abroad. Global economic activity has been very subdued recently.

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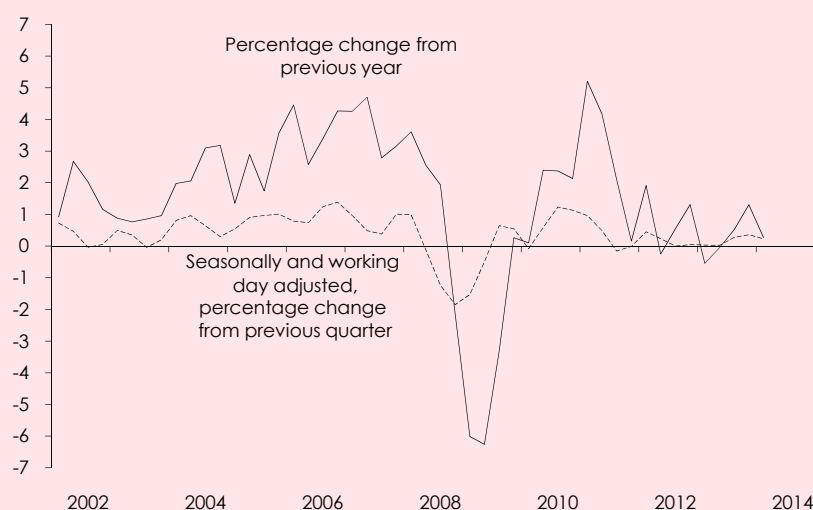
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Global economic growth is continuing, but its pace moderated somewhat in both advanced and emerging market economies in the first quarter of 2014. Renewed financial market turbulence experienced at the beginning of the year in some emerging market economies ebbed rapidly. A few unexpectedly negative economic indicators also weighed only little on economic activity. Apparently the robust underlying momentum of the global economy and the – despite the gradual tapering of asset purchases by the central bank of the USA – ongoing expansionary stance of fiscal policy of the major advanced economies acted as a shield against financial market developments. The global economy is expected to at least maintain its modest pace of expansion in the current quarter. Leading indicators continue to signal a gradual pick-up in growth, which will, however, be uneven in the advanced and emerging market economies.

The Austrian economy expanded by 0.2 percent in the first quarter of 2014, compared with the previous quarter (fourth quarter of 2013 real GDP +0.4 percent). Hence the upturn, while not accelerating, did at least strengthen. Economic growth, which is supported by broad-based demand, has been increasingly receiving stimulus from abroad again since the third quarter of 2013. The weather has also had a great deal of influence recently; the extremely warm and dry winter benefited business activity in outdoor job sectors. Heightened geopolitical tensions have dampened sentiment among domestic businesses and private households only recently, as leading indicators show.

HICP inflation was 1.6 percent in April 2014, slightly higher than in the preceding months and markedly higher than the euro area average. Inflationary pressures in Austria in April were again largely determined by price increases for hotel and restaurant services, housing, water and energy.

Figure 1: Growth of real GDP



Source: WIFO.

Table 1: Quarterly national accounts

			2012	2013			2014	
			Fourth quarter	First quarter	Second quarter	Third quarter	Fourth quarter	First quarter
Percentage changes from previous quarter								
<i>Adjusted for seasonal and working day effects, volume</i>								
Final consumption expenditure			- 0.0	+ 0.2	+ 0.2	+ 0.1	+ 0.1	+ 0.3
Households ¹			- 0.0	+ 0.0	+ 0.1	+ 0.1	+ 0.1	+ 0.1
General government			+ 0.4	+ 0.6	+ 0.5	+ 0.4	+ 0.3	+ 0.4
Cross capital formation			- 1.2	- 1.3	- 0.5	- 0.7	- 0.4	- 0.8
Gross fixed capital formation			- 0.4	- 0.3	+ 0.1	+ 0.2	- 0.3	- 0.0
Machinery and equipment			- 1.0	- 0.2	- 0.3	- 1.1	- 1.0	- 0.3
Construction			+ 0.2	+ 0.3	+ 0.5	+ 0.6	+ 0.6	+ 0.4
Exports, goods and services			+ 0.2	+ 0.4	+ 0.6	+ 1.2	+ 1.3	+ 1.5
Goods			- 0.5	+ 0.5	+ 0.7	+ 1.3	+ 1.2	+ 1.6
Services			+ 0.8	+ 0.6	+ 0.2	- 0.0	- 0.1	+ 0.4
Imports, goods and services			- 0.3	- 0.1	+ 0.5	+ 0.9	+ 0.7	+ 0.6
Goods			- 0.7	- 0.4	+ 1.1	+ 1.2	+ 0.7	+ 0.3
Services			+ 0.9	+ 0.3	- 0.6	+ 0.5	+ 0.9	+ 1.2
Gross domestic product			+ 0.0	+ 0.0	+ 0.0	+ 0.3	+ 0.4	+ 0.2
Manufacturing			- 0.7	+ 0.4	+ 0.6	+ 0.5	+ 0.6	+ 0.1
	2012	2013	2012	2013			2014	
			Fourth quarter	First quarter	Second quarter	Third quarter	Fourth quarter	First quarter
Percentage changes from previous year								
<i>Volume, chained prices</i>								
Final consumption expenditure	+ 0.4	+ 0.3	- 0.8	- 0.3	- 0.3	+ 1.1	+ 0.7	+ 0.6
Households ¹	+ 0.5	- 0.2	- 1.1	- 0.9	- 0.7	+ 0.4	+ 0.5	+ 0.3
General government	+ 0.2	+ 1.6	+ 0.2	+ 1.4	+ 0.8	+ 3.0	+ 1.3	+ 1.4
Cross capital formation	- 1.2	- 6.1	+ 7.1	- 15.6	- 6.9	- 1.7	- 2.6	+ 3.1
Gross fixed capital formation	+ 1.6	- 0.7	- 0.1	- 3.2	- 0.8	- 0.3	+ 0.8	+ 0.5
Machinery and equipment	+ 2.1	- 3.4	- 2.1	- 7.0	- 1.3	- 2.4	- 2.6	- 2.7
Construction	+ 2.5	+ 1.2	+ 1.4	+ 0.9	- 0.3	+ 0.9	+ 2.8	+ 4.0
Exports, goods and services	+ 1.2	+ 2.7	+ 0.4	+ 2.2	+ 3.7	+ 2.2	+ 2.7	+ 1.8
Goods	+ 0.4	+ 2.7	- 0.4	+ 0.7	+ 4.3	+ 2.2	+ 3.7	+ 3.2
Services	+ 3.3	+ 2.5	+ 2.5	+ 5.3	+ 2.1	+ 2.1	+ 0.2	- 1.5
Imports, goods and services	- 0.3	+ 0.5	- 0.2	- 1.9	+ 0.0	+ 2.3	+ 1.5	+ 4.2
Goods	- 1.4	+ 0.3	- 1.4	- 2.9	+ 0.1	+ 2.8	+ 1.4	+ 4.0
Services	+ 4.5	+ 1.1	+ 5.3	+ 2.8	- 0.5	+ 0.7	+ 1.9	+ 5.6
Gross domestic product	+ 0.9	+ 0.3	+ 1.3	- 0.5	- 0.1	+ 0.5	+ 1.3	+ 0.3
Manufacturing	+ 1.2	+ 1.5	+ 0.8	- 1.9	+ 0.9	+ 2.4	+ 4.5	+ 0.8
Gross domestic product, value	+ 2.6	+ 2.0	+ 3.6	+ 1.4	+ 1.8	+ 2.2	+ 2.5	+ 1.5

Source: WIFO. – ¹ Including private non-profit institutions serving households.

The situation in the labour market remains very tense – owing to under-utilisation of capacity and the quickly growing labour supply compared with a year before, the unemployment rate was also high in May (8.5 percent, seasonally adjusted).

1. Heterogeneous dynamism of global economy

Global economic growth is continuing, but its pace slowed somewhat in both industrialised and emerging market economies in the first quarter of 2014. Economic growth in China was relatively weak at the beginning of this year, as already in previous years, and Russia's economic problems were exacerbated noticeably by the Ukraine crisis. Contrary special factors came to bear in advanced countries: while in the United States the extremely harsh winter partly caused a sharp slowdown in production, Japan experienced a considerable increase in domestic demand and hence in real gross domestic product as a result of the strong impact of households' bringing forward purchases in anticipation to the value added tax increase with effect from 1 April 2014.

1.2 US economy shrank in the first quarter of 2014

According to the second estimate by the U.S. Bureau of Economic Analysis, US gross domestic product contracted marginally (–0.2 percent) in quarter-on-quarter terms in the first quarter of 2014, due especially to the unusually severe winter. Most affected were investment other than residential investment (especially equipment investment) and exports. Private consumption, by contrast, was relatively lively, and government spending as well as residential investment declined at a slower pace than in the fourth quarter of 2013.

The picture painted by leading indicators has improved recently in parallel with the waning of the unfavourable weather effects, suggesting a pick-up in economic activity in the second quarter. Industrial production and new orders received by manufacturers of consumer goods gained traction already in March. The recovery of the labour market has accelerated recently, with non-farm payroll employment rising sharply in April. The indicators derived from consumer and business surveys in May also support expectations for a fast economic recovery.

Owing to the harsh winter, the US economy contracted for the first time in three years in the first quarter of 2014.

1.3 Effects of frontloading of consumption support growth in Japan

In Japan, economic activity gained traction in the first quarter of 2014 (+1.5 percent, compared with the previous quarter), which is apparent for instance in the substantial growth in retail sales and the strengthening of imports in March. However, this development was largely due to the effects of households' bringing forward purchases in anticipation of the entry into force of the value added tax increase from 5 percent to 8 percent on 1 April 2014 – current sentiment indicators signal momentum will wane in the second quarter. The Manufacturing Purchasing Managers' Index recently fell below the expansion threshold of 50. The results of the Tankan survey conducted among large-sized enterprises also suggest that the situation will deteriorate in the second quarter.

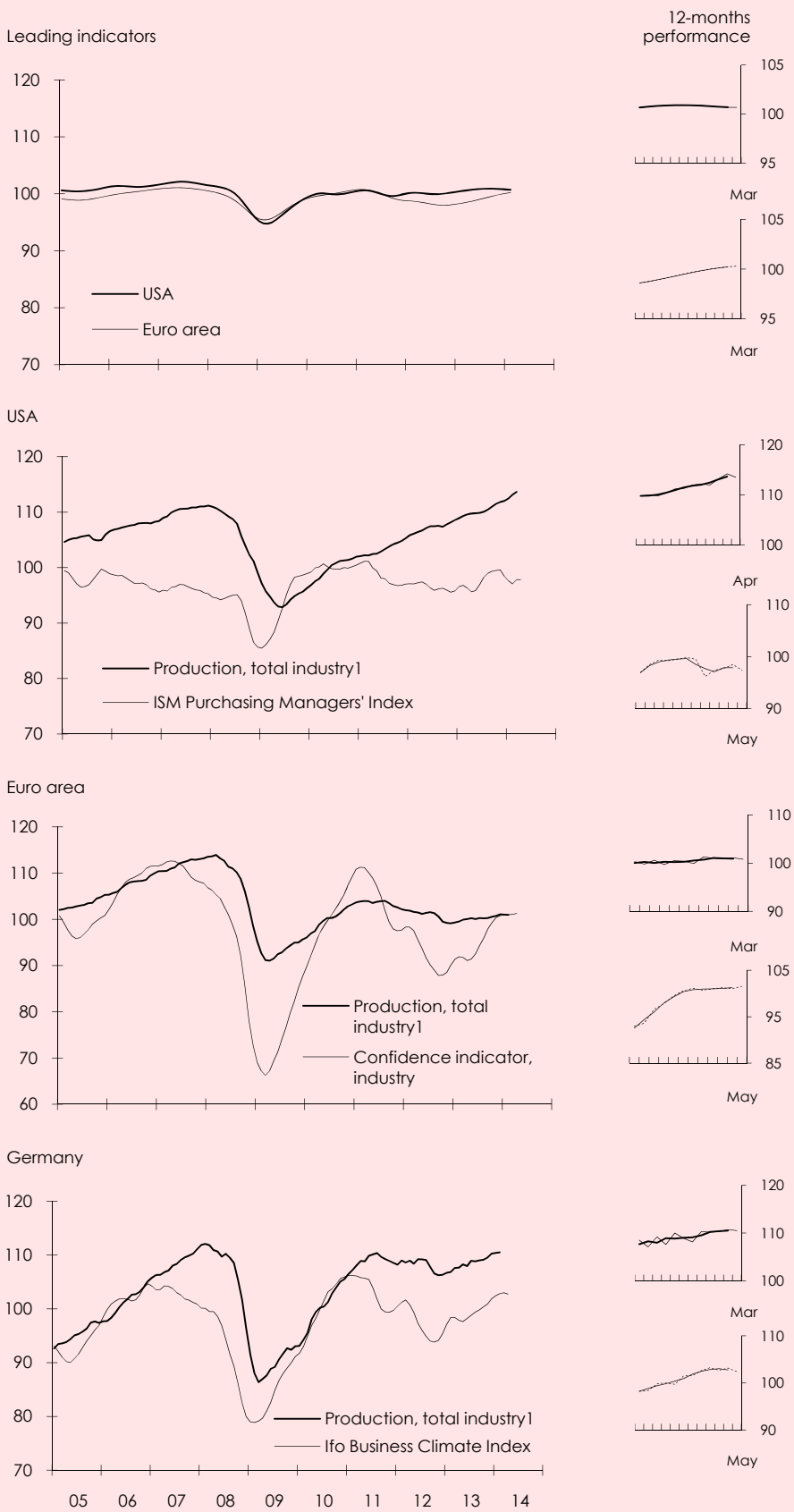
1.4 Economic activity tepid in China

In China, economic activity moderated in the first quarter of 2014 on the back of some temporary factors (+1.4 percent, compared with the previous quarter). Monthly leading indicators, for instance those for industrial production, housing market developments and retail sales, had already signalled this development. The slowdown in growth was broad-based, but it was particularly pronounced in the secondary sector, owing to various interventions by the Chinese authorities aimed at limiting credit growth in the shadow banking sector. Consumption had a stabilising effect, while net trade contributed negatively. China's central bank took expansionary measures (e.g., reduction of minimum reserve requirements for some banks in rural areas) so as to support recently sluggish growth.

The Chinese national bank is taking expansionary measures to support economic activity.

Figure 2: 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.

1.5 Subdued growth in euro area

In the euro area, real gross domestic product expanded by 0.2 percent on a seasonally adjusted quarter-on-quarter basis in the first quarter of 2014. Hence the recovery is progressing only very slowly.

Economic developments remain highly heterogeneous across euro countries. In the first quarter, Germany was once more the driver of growth (+0.8 percent), owing exclusively to the expansion of domestic demand. By contrast, gross domestic product stagnated in France, and contracted slightly in Italy. At -1.4 percent in real terms compared with the previous quarter, the Netherlands registered the worst result of all euro countries (special factors: decline in consumption, production and export of natural gas owing to the mild winter). In Portugal, the drop in exports was largely responsible for the contraction in the first quarter (-0.7 percent, compared with the previous quarter). In Spain, economic growth of 0.4 percent suggests that the crisis is gradually being overcome. Overall, economic output expanded at a somewhat slower pace in the euro area than on average in the EU as a whole, given that the UK (+0.8 percent) and some Eastern European countries (Poland and Hungary +1.1 percent each) recorded the highest growth rates in the EU.

Leading indicators suggest that the modest recovery will continue in the second quarter. Domestic demand should continue to be supported by a number of factors, including the ongoing accommodative monetary policy stance, further improvements in financing conditions and the favourable development in energy prices. Although the situation in the labour market has stabilised and there are tentative signs of an improvement in economic conditions, unemployment and under-utilisation of capacity remain high in the euro area. Moreover, the restriction of loans to the private sector as a result of adjustments of outstanding amounts of balance sheets in the public and private sectors continues to negatively affect the pace of recovery of the real economy. Nevertheless, the results of the April 2014 bank lending survey confirm a stabilisation of credit conditions for businesses and private households. For instance, the requirements for business loans have remained largely unchanged over the last three months; those for private households have even been eased.

Financing conditions for corporate as well as for government bonds have generally improved further in the European capital market. This development supports the recovery in the euro area and is largely a result of portfolio restructuring of banks operating globally. Increased uncertainty about the economic outlook for emerging market economies on the one hand, and the pick-up in activity in advanced economies on the other hand, caused a considerable re-orientation of global capital flows: capital was withdrawn to a large extent from emerging market economies and reinvested in advanced economies. This development is also reflected in exchange rate developments. The firming of the euro exchange rate must therefore also be seen in the context of euro area portfolio investment inflows, which for their part contributed to a decline in corporate and government bond yields. All in all, the capital inflow from emerging market economies provides a clearly positive impetus to European peripheral economies, in spite of the related appreciation of the euro. The euro has lost somewhat in value again in nominal effective terms since the beginning of this year, while the yields on 10-year government bonds have fallen even further recently.

Economic activity in the euro area accelerated slightly in the first quarter of 2014, and the general picture presented by leading indicators also remains positive. However, this stabilisation is not yet reflected in labour market conditions: unemployment is still high in the euro area. Moreover, economic developments continue to diverge considerably across countries.

The strong capital inflows into the euro area on account of uncertainties prevailing in many emerging market economies dampen yields in bond markets; this facilitates general government financing in Europe's crisis countries.

2. Austrian economic growth subdued also in the first quarter of 2014

The Austrian economy expanded by 0.2 percent in the first quarter of 2014, compared with the previous quarter. Hence activity still did not gain pace (fourth quarter of 2013 +0.4 percent). For the year 2013 as a whole, economic growth was 0.3 percent. Domestic demand is expanding at a steady, albeit still very subdued pace. Household consumption once again grew only very modestly, while general government consumption posted stronger growth. Gross fixed capital formation remains stagnant. Construction investment did increase further, but equipment investment

declined yet again. The increased demand for vehicles did not offset the continuing weak development of machinery investment.

The Austrian economy received substantial stimulus from external trade in the first quarter of 2014. Exports grew at a somewhat faster quarter-on-quarter pace than in the fourth quarter of 2013. The dynamism of Austrian exports in January and February was driven notably by the demand from overseas (Asia, South America), while exports to European countries remained almost flat.

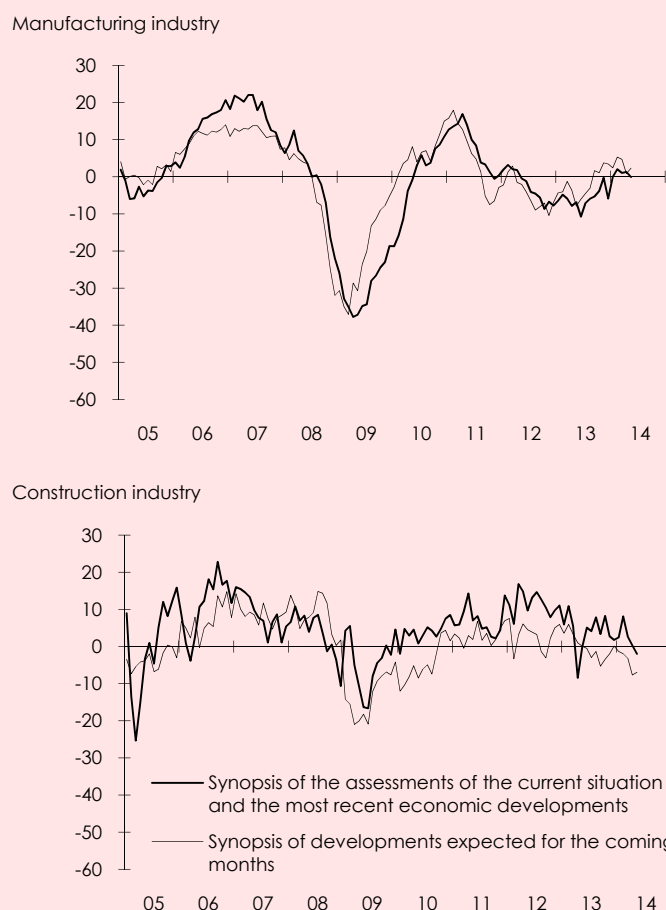
2.1 Industrial activity continues to lose momentum

In May, the Purchasing Managers' Index compiled by Bank Austria fell to the lowest level recorded since the middle of last year. The monthly survey shows a flattening of industrial activity with only modest production growth owing to a lacklustre order environment. At 50.9 points, the indicator did continue to signal growth of the Austrian industry in May, but the recovery has slowed down noticeably. Austria's industry suffers from the significant moderation in economic activity in emerging market economies and the still very tepid recovery in the euro area. According to the Bank Austria survey, production rose at a much slower pace in May given that almost no new orders were received overall. The slackening domestic demand was offset by new, albeit not very numerous, export orders.

Expectations for activity in the coming months have recently deteriorated notably in the cyclically sensitive manufacturing sector.

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.

The WIFO Business Cycle Survey also shows this deterioration in leading indicators. In May, Austrian businesses assessed the present economic situation less favourably

than in April. The Present Situation Index for the economy as a whole fell to 1.9 points, seasonally adjusted, in May (April 4.5 points). This trend is relatively uniform across all sectors. However, expectations for the coming months are slightly more optimistic again. In May, firms judged global economic risks to be smaller than a month earlier, and the business expectations index rose by 2 points to 3.6 points, the same reading as in March. Again, the increase was broad-based across all sectors.

WIFO's Leading Indicator remained almost unchanged from the previous month in May. This is the result of a highly heterogeneous development of the sub-components of the indicator. The components relevant to manufacturing improved generally, whereas consumer confidence and the confidence indicator for the retail trade deteriorated markedly.

2.2 Declining volatility in financial markets

Financing conditions have improved markedly in Austria since the beginning of 2014. Owing to extensive capital inflows to Europe, Austria has also seen a substantial decline in yields on government bonds as well as for domestic banks and non-banks. The increase in liquidity is also reflected in the stock market in the form of extremely low volatility. Hence the financing environment would remain advantageous for the Austrian economy. But this favourable development in the capital market is apparent only to a limited extent in the Austrian loan market. The evidence presented in WIFO's Business Cycle Survey of May shows that in the three previous months, half of the loan-seeking companies did receive the expected amount of the loan applied for and on the terms expected, while one fifth had to accept a reduction in the amount and/or changed terms, and 28 percent of the companies were not able to get a bank loan in spite of need. Hence the proportion of companies receiving a loan only on worse terms than expected was noticeably lower than in February, but the proportion of companies not receiving any loan was considerably higher.

Just under one third of the companies surveyed describe the banks' current lending practices as being restrictive. As in past surveys, this proportion declines slightly with rising company size.

The current Bank Lending Survey shows that on the credit-supply side lending standards have barely changed recently, except for a minor tightening of credit conditions. The standards for loans to small and medium-sized companies as well as to private households remained unchanged, whereas those for loans to large-scale enterprises were tightened somewhat. The financial institutes surveyed slightly widened their margins for both borrowers with average credit-worthiness and higher-risk loans; moreover, their handling of incidental expenses, credit amount and period of maturity became more restrictive.

Lending remains subdued in Austria, despite the improved refinancing situation of domestic banks.

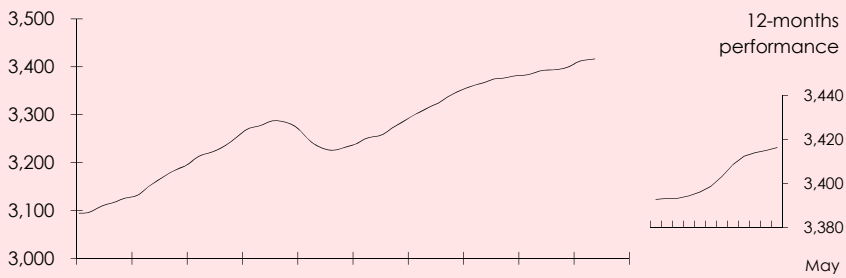
2.3 Drop in tourism revenue in winter season 2013-14

In the 2013-14 winter season, tourism revenue reached € 11.63 billion, a decline by 2.8 percent from the level recorded in the winter of 2012-13, according to preliminary estimates. In real terms, the decline was 4.4 percent. The price-adjusted expenditure per night spent also fell (-2.7 percent) – an indication of increased demand for accommodation of lower – in terms of quality – standard.

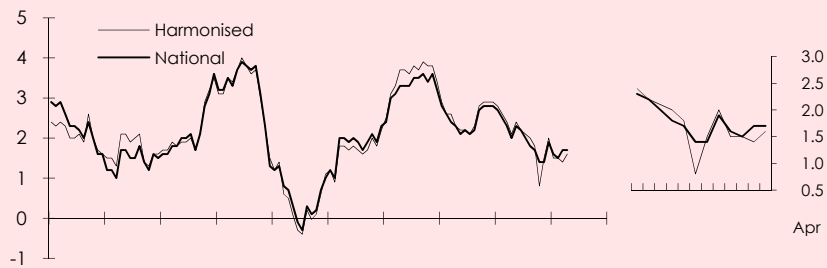
While in the period from November 2013 to April 2014 more guests came to Austria (+0.8 percent), the number of nights spent fell by 1.7 percent, compared with a year before, owing to the shorter length of stays. Especially international demand developments (-1.9 percent) had an adverse effect on the overall result; domestic demand declined at only around half that pace (-1.0 percent). Decisive factors for the unsatisfactory outcome of the 2013-14 winter season were the relatively mild temperatures and much too little snow north of the main ridge of the Alps.

Only commercial holiday apartments recorded an increase in the number of nights spent (+1.8 percent); the number of nights spent in 5&4-star hotels (-0.6 percent) also posted a below-average decline (-1.7 percent overall). By contrast, overnight stays in other kinds of accommodation fell by 2.9 percent.

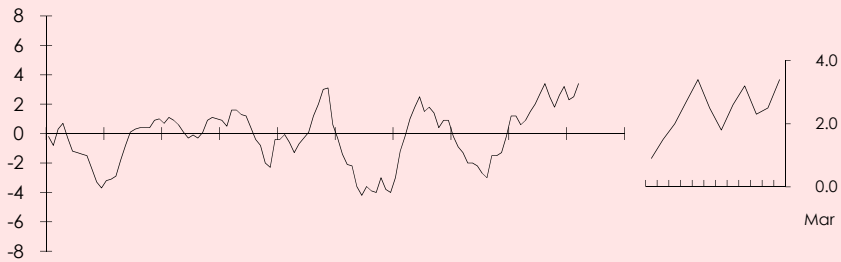
Figure 4: Key economic indicators

Persons in active dependent employment¹, (1,000), seasonally adjustedUnemployment 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 parental leave, military service, and unemployed persons in training. – ² As a percentage of total labour force excluding self employed, according to Public Employment Service.

Demand developments in the 2013-14 winter season were quite diverse across the major international source markets: while a marked increase was recorded in the number of nights spent by guests from the USA (+7.9 percent) and from Poland (+5.3 percent), the demand from Belgium (+2.1 percent), Switzerland (+1.1 percent) and the Czech Republic (+0.9 percent) expanded at a modest pace. Overnight stays by travellers from Russia exceeded the year-earlier level only marginally (+0.3 percent). All the other major source markets registered a decline in demand, especially Germany, the most important market for Austria (-4.3 percent). Overnight stays by travellers from France (-4.1 percent) and Romania (-3.3 percent) also fell noticeably. Above-average declines were registered in the number of nights spent by guests from the UK (-1.8 percent), the Netherlands (-1.3 percent), Denmark (-1.2 percent), Sweden (-1.1 percent), Italy (-0.7 percent) and Hungary (-0.6 percent).

In three federal provinces, tourism sales in the 2013-14 winter season posted some significant increases compared with year-earlier levels (Vienna, Burgenland, Styria). The sales decline was relatively small in Carinthia and Lower Austria, and below average also in Upper Austria. Much higher declines were registered by the tourism industry in the tourism-intensive federal provinces of Salzburg, Tyrol and Vorarlberg.

2.4 Inflation in Austria exceeds euro area average

The rate of inflation measured by the consumer price index was 1.7 percent in April 2013, unchanged from March, according to Statistics Austria. About $\frac{1}{4}$ percentage point of the rise in inflation is attributable to consumption tax increases at the beginning of March. Price increases in the "Housing, Water, Energy" expenditure categories (rise in apartment rents and maintenance costs) had the greatest impact. Total expenditure on household energy proved stable, but the prices for the individual kinds of energy followed contrasting trends. Food and restaurant prices rose at a slower pace than in March. Package holidays became more expensive again compared with a year before, especially due to the late timing of Easter, while fuel prices did not fall as markedly as in previous months.

The rate of inflation measured by the harmonised index of consumer prices stood at 1.6 percent in April (March 1.4 percent). Hence the inflation rate in Austria exceeded the euro area average (0.7 percent, March 0.5 percent) by just under 1 percentage point and was the highest rate of all euro countries. At $+\frac{1}{2}$ percentage point, services prices were decisive for the difference in the inflation rate compared with the euro area average (restaurants and cafeterias as well as telecommunication around +0.2 percentage point in both cases, medical services around 0.1 percentage point). In addition, 0.15 percentage point is attributable to sharper price increases for industrial products in Austria, and 0.2 percentage point to higher price increases for food, alcohol and tobacco.

2.5 Still no recovery of labour market

The number of persons in dependent active employment exceeded the year-earlier level by 25,000 in May, according to provisional data. This is an increase of 0.7 percent. Compared with a month before, employment (seasonally adjusted) remained flat. The number of job vacancies registered with the Public Employment Service rose again in May (+1,500, compared with a year before). So did the number of persons unemployed: in May, around 291,000 persons were registered as unemployed, an increase by 39,000 from the same month last year. The seasonally adjusted unemployment rate rose to 8.5 percent, according to the Austrian method of calculation.