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Little Evidence for Weakening Business Activity

Business Cycle Report of March 2018

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Economic growth is currently robust, both internationally and in Austria, and should sustain its momentum in the months to come. Austria's labour market keeps recovering, even if unemployment stays high. Inflation has somewhat eased lately, narrowing the differential vis-à-vis the euro area.

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JEL-Codes: E32, E66 • **Keywords:** Business Cycle Report

All staff members of the Austrian Institute of Economic Research contribute to the Business Cycle Report. For definitions used see "Methodological Notes and Short Glossary", <http://www.wifo.ac.at/wwadocs/form/WIFO-BusinessCycleInformation-Glossary.pdf> • Cut-off date: 8 March 2018.

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ISSN 1605-4709 • © Austrian Institute of Economic Research 2018

Impressum: Herausgeber: Christoph Badelt • Chefredakteur: Michael Böheim (michael.boeheim@wifo.ac.at) • Redaktionsteam: Tamara Fellingner, Ilse Schulz, Tatjana Weber • Medieninhaber (Verleger) und Redaktion: Österreichisches Institut für Wirtschaftsforschung • 1030 Wien, Arsenal, Objekt 20 • Tel. (+43 1) 798 26 01-0 • Fax (+43 1) 798 93 86 • <http://bulletin.wifo.ac.at> • Verlags- und Herstellungsort: Wien

The world economy keeps growing strongly and should sustain the lively momentum in the next few months. GDP in the USA rose by a noticeable 0.6 percent quarter on quarter in the fourth quarter 2017, with private consumption and investment proving particularly buoyant. Business cycle indicators climbed once again and currently hold a very high level. Consumer spending is likely to benefit further from upbeat expectations and the favourable labour market situation. A low rate of labour force participation and the absence of inflationary pressure suggest that US labour reserves are not yet exhausted.

Cyclical risks have nevertheless been rising lately in the USA. Stock market values have become more volatile since the beginning of the year, the private household saving ratio has dropped to a level not seen since 2005, and outstanding consumer credit has expanded significantly. Likewise, real estate prices have rebounded strongly over the last few years. Private household debt, on the other hand, in relation to disposable income, is still well below the record of 2008.

Business activity is firm also in the euro area. From October to December 2017, seasonally-adjusted GDP gained 0.6 percent quarter on quarter. Growth was strong in Germany, France, Spain and many of the smaller euro area countries. Confidence in the actual situation and the short-term outlook remains positive, despite some minor weakening of late. Cyclical strength is thus expected to extend into the coming months, benefitting also from benign labour market conditions. The unemployment rate of 8.6 percent in January was the lowest rate recorded in the last eight years. Unemployment and labour reserves nevertheless remain high in many countries. Inflation has so far been subdued, at an annual rate of +1.2 percent in February, according to a first HICP estimate.

In Austria too, economic growth was strong in the fourth quarter 2017, with seasonally-adjusted GDP rising by 0.9 percent quarter on quarter. Major drivers were ex-

ports and gross fixed capital formation, but also robust private consumption. The economy looks set to keep such strong momentum in the next few months. In the regular WIFO-Konjunkturtest (business cycle survey), firms express strong optimism, both with respect to current business conditions and to short-term prospects. Expectations have further improved notably in the manufacturing sector, but have softened slightly in services. Consumer confidence is unabatedly high.

The Austrian labour market is also moving in a positive direction. The number of persons in active dependent employment was higher by 104,200 or 3 percent in January than one year ago. Lively aggregate demand fuelled job creation particularly in the manufacturing sector, while clement weather conditions boosted the hiring of construction workers. Unemployment receded further in February, both year-on-year and seasonally adjusted compared with a month before. With 7.9 percent (on national definition) it still significantly exceeded the level recorded before the financial and economic crises.

Headline inflation (CPI) eased to 1.8 percent in January (HICP +1.9 percent). The relatively high inflation differential vis-à-vis the euro area average diminished slightly. Upward pressure mainly derived from higher costs of the categories "housing, water and energy" as well as "restaurants and hotels".

1. Private consumption and investment fuelling activity in the USA

US GDP rose by a noticeable 0.6 percent quarter on quarter in the fourth quarter 2017, although somewhat less than in the two earlier quarters. Activity was driven once again by buoyant private consumption and a similarly strong pick-up of investment. Imports, for their part, also increased significantly and inventories were slightly cut.

Business cycle indicators in the USA presage a persistently positive trend. The ISM Purchasing Managers' Index climbed markedly in February, after having edged down in January. Consumer confidence strengthened substantially in February, as witnessed both by the Conference Board and the Consumer Confidence Indicator of the University of Michigan. Industrial output in January was broadly unchanged from the previous month.

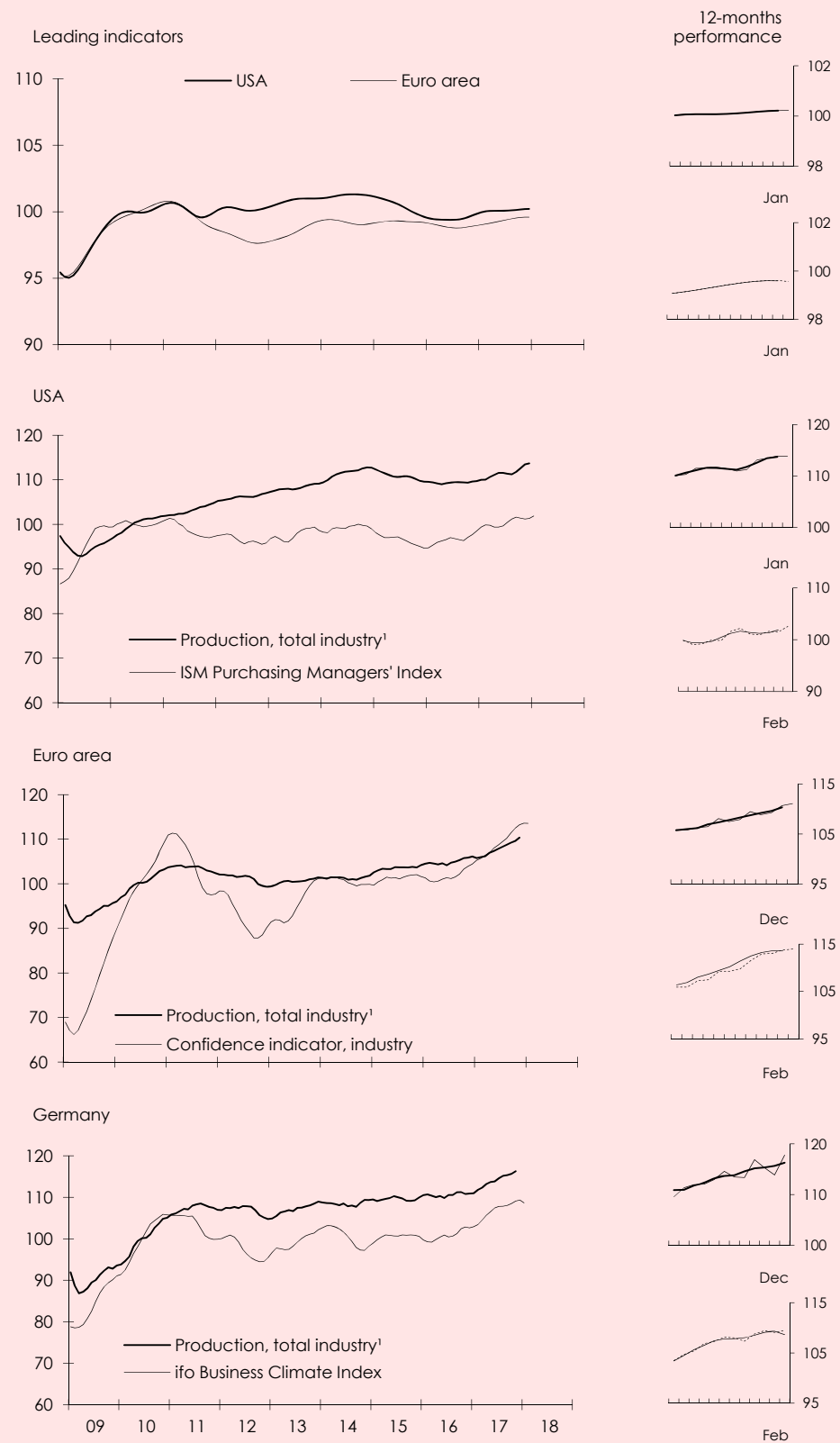
One reason for the optimism of US consumers is the persistently favourable labour market situation. The unemployment rate of 4.1 percent in January was the lowest in more than 15 years. Also the numbers of long-term unemployed and of involuntary part-time workers were substantially lower than one year earlier. Since October 2017, however, the jobless rate has been broadly stable and labour force participation has barely changed over the last twelve months, although employment has strongly increased during that period. The demand for additional labour has to a large extent been met by a growing labour force. While hourly wages rose noticeably year-on-year in January, wage pressure has hardly been accelerating so far. Overall inflation has not increased, either, suggesting that the US labour market still holds untapped reserves.

The booming consumption was not only driven by benign labour market conditions and rising wages, but was also accompanied by a steady decline in the private household saving ratio that fell in the fourth quarter 2017 to a low not seen since 2005. Consumer credit also expanded as a share of disposable income. A further factor boosting consumer confidence is probably the increase in real estate prices which according to the Standard & Poor's Case-Shiller-Index have climbed strongly since 2011, being now almost twice as high as in 2000. Private household debt has nevertheless hardly increased so far as a proportion of disposable income, still being far below the level of 2008.

Business activity in the USA remains lively, as cyclical indicators keep heading up. Private consumption and investment are the main drivers of 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.

2. Stock market volatility on the rise

An ominous sign comes from stock markets, where volatility has increased markedly in recent months. At the end of January, the S&P 500 Stock Price Index for the USA was 80 percent higher than in 2007 and more than 30 percent above the level prior to the presidential elections. A slump in early February gave way to further ups and downs followed by many stock markets around the world. The rise in US stock market values in 2017 is deemed to partly reflect higher profit expectations as a result of the tax reform. Recent developments nevertheless show that changing expectations may trigger sudden price corrections at any time and that even a severe slump with adverse repercussions for the real economy like between 2000 and 2002 cannot be ruled out.

Stock prices in the USA rose strongly in 2017. Following losses in early February 2018, stock market volatility has increased worldwide.

3. Prospects for the euro area clouding slightly, though remaining broadly favourable

The euro area remained on a firm growth path throughout 2017, as seasonally-adjusted GDP rose by 0.6 percent quarter on quarter in the fourth quarter. Lively activity extended to almost all of the major economies, with growth rates of +0.6 percent recorded for Germany and France and +0.7 percent for Spain; in Italy, the pace remained at a more subdued +0.3 percent.

Economic agents judge the current situation favourable and remain optimistic for the next few months. In the business survey of the European Commission, the Economic Sentiment Indicator (ESI), though edging down in February, remained high overall. Consumer sentiment and industrial confidence softened markedly. Production expectations receded, although firms were highly satisfied with order levels. More cautious expectations were expressed in Germany, France and Spain, while confidence picked up in Italy.

The rate of unemployment remained unchanged at 8.6 percent in January, the lowest rate recorded in the last eight years. Although the rate has fallen by 1 percentage point from one year ago, it is still 1½ percentage points higher than before the onset of the financial and economic crises. Whereas unemployment has eased in almost all euro area countries, it still exceeds the pre-crisis level in Greece, Cyprus, Spain and Italy far more than in the euro area as a whole.

Inflation remains moderate in the euro area. On first estimates, the Harmonised Index of Consumer Price (HICP) was 1.2 percent higher in February than one year ago. The pace of inflation has slightly decelerated in recent months. Core inflation (HICP excluding energy and unprocessed food) also stood at +1.2 percent, broadly unchanged from the previous periods.

Growth in the euro area is lively and should keep up its momentum in the next few months, although sentiment has somewhat clouded lately.

4. Austria: strong economic activity in late 2017

The Austrian economy kept its strong growth momentum throughout 2017, as GDP rose by 0.9 percent (trend-cycle component) in the fourth quarter from the earlier period. Business activity was particularly vibrant in the manufacturing sector, where net output (value added) gained 3 percent quarter-on-quarter.

Growth was driven by strongly expanding exports, reflecting the lively business activity abroad. Investment also increased significantly, even if gains turned out lower than in the two previous quarters. In particular, investment in machinery and equipment posted strong gains throughout 2017. Construction investment, on the other hand, lost some momentum. Private consumption also provided firm support to activity. Inventory build-up added to GDP growth in the second and third quarter, but subsided thereafter.

The stimulus from international business conditions is reflected by the rise in Austrian exports (from January to November 2017 nominal +8.6 percent year on year, according to the foreign trade statistics). Developments in the tourism industry were equally benign: gross earnings in the first half of the winter season grew by 7 percent

Demand and output in Austria gained 0.9 percent quarter-on-quarter in the last three months of 2017. Exports and business investment were the main drivers of growth.

at current prices. Overnight stays went up by nearly 6 percent in total, over three quarters of which was owed to foreign customers.

4.1 Economy keeps strong expansionary pace

The strong pace of expansion of the Austrian economy is continuing in the first half of 2018. In the last WIFO-Konjunkturtest, firms have further revised up their assessment of the current situation, with the respective index reaching a new high on a seasonally-adjusted basis in February. Manufacturers in particular were more satisfied now than one month ago, reversing the slight decline of the index in January. Service providers also expressed greater optimism than in the previous month, while for the construction sector the index for current business conditions remained close to its top readings despite a slight decline.

Firms also expressed strong optimism on the short-term outlook. The respective index confirmed its high level, but did not rise much further in February. While service sector firms turned somewhat more cautious, manufacturers revised up their forward-looking expectations. Confidence was highest among producers of capital goods and consumer goods, whereas the index for the primary products industry declined for the third time in a row.

In the European Commission business survey, both industrial and consumer confidence strengthened markedly in February, while sentiment in the construction sector has clouded since December. Overall, indicators nevertheless suggest favourable cyclical conditions to last throughout the first six months of 2018.

Cyclical prospects for the next few months are unabatedly positive. The Austrian economy can expect strong growth for the first half of 2018.

Figure 2: Results from the WIFO-Konjunkturtest

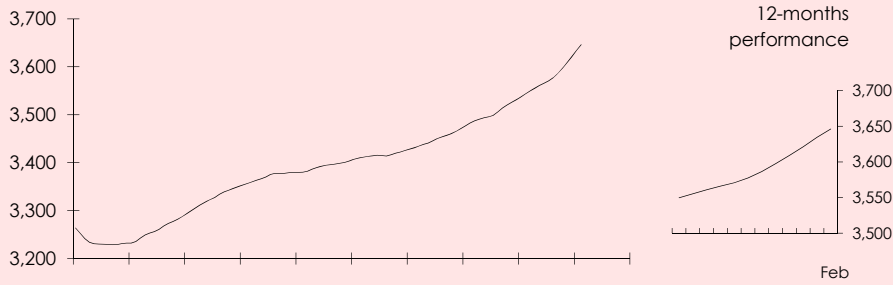
Indices of the assessment of the current economic situation and of business expectations, seasonally adjusted



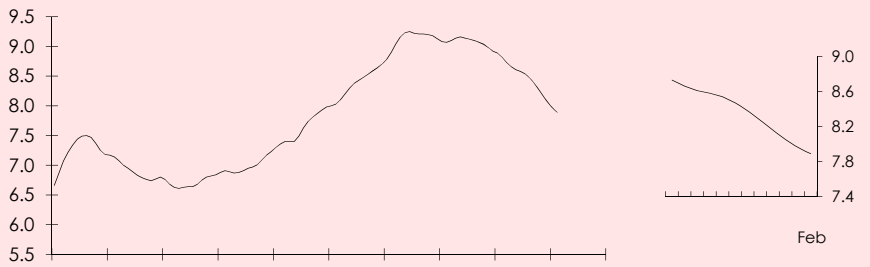
Source: WIFO-Konjunkturtest. Data refer to index points (percentage points) between +100 and -100. Values above 0 imply positive expectations, values below 0 indicate negative expectations.

Figure 3: Key economic indicators

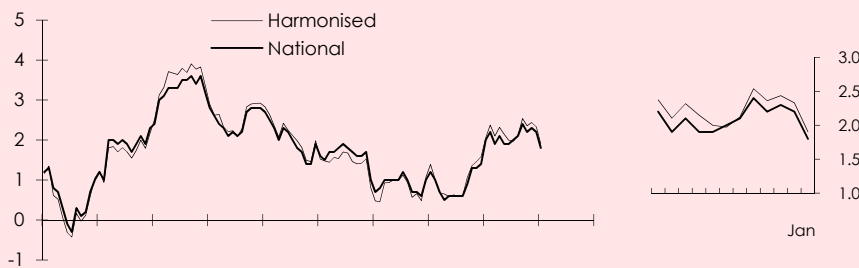
Persons in active dependent employment¹, 1,000s, seasonally adjusted



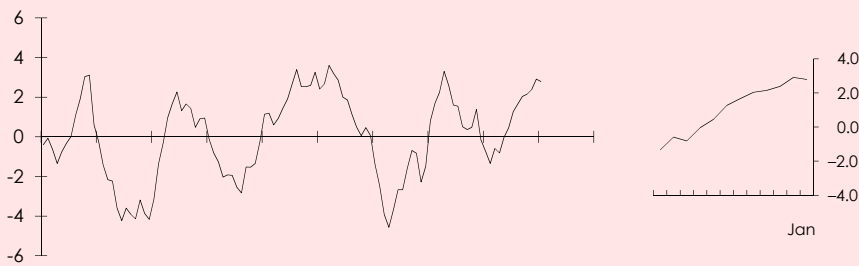
Unemployment rate, traditional Austrian method², seasonally adjusted



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.

4.2 Labour market recovery on a broadening base

Thanks to the rebound in demand and output, labour market conditions in Austria are improving further. In January, the number of persons in active dependent employment rose by 104,200 or 3 percent year-on-year. On a seasonally-adjusted basis, employment went up by 13,300 or 0.4 percent from December 2017. Since last summer, job creation has strengthened substantially, notably in the manufacturing sector. Labour demand was buoyant also in the construction sector, mainly due to the exceptionally warm weather prevailing in January. Besides, the end of January marked the deadline for applications for the expiring "employment bonus", so that the monthly increase may also include carry-forward effects.

The number of unemployed registered with the Public Employment Service Austria (AMS) was by 36,000 persons or 9 percent lower in February than one year ago (including persons enrolled in job training -31,400 or -6.6 percent). The seasonally-adjusted jobless figure eased by 0.6 percent on the month. The rate of unemployment, on national definitions, edged down by 0.1 percentage point to 7.9 percent in February, excluding seasonal variations; in a year-on-year comparison, the jobless rate fell by 1.1 percentage points. Increasingly, long-term unemployed (-12.3 percent year-on-year), older unemployed (-4.8 percent) and jobseekers suffering from health restrictions (-2.3 percent) are benefitting from better labour market conditions.

4.3 Inflation differential vis-à-vis the euro area narrowing slightly

The year-on-year increase in the Consumer Price Index (CPI) of 1.8 percent in January 2018 was significantly lower than in the preceding months. A major dampening factor were price cuts for package holidays, leading to a lower inflation contribution of the index category "recreation and culture". The highest contributions came from the categories "housing, water and energy" as well as "restaurants and hotels".

The overall inflation rate was still above the euro area average (HICP Austria +1.9 percent, euro area +1.3 percent), although the gap has narrowed markedly. Apart from stronger price increases for hotel and restaurant services, higher inflation in the category "recreation and culture" was responsible for the positive differential vis-à-vis the euro area.

The price index for the "micro basket of goods" (i.e. daily purchases) exceeded the year-earlier level by 4.6 percent, the index for weekly purchases by 3.5 percent. The HICP core inflation rate further moderated in January (+2.1 percent), albeit less than the overall rate.

The increase in employment accelerated noticeably in January. Also long-term unemployed and older job-seekers increasingly benefit from the recovery.

Headline inflation in Austria eased markedly in January. Major price increases were recorded for the categories "housing, water and energy" as well as "restaurants and hotels".