

Marcus Scheiblecker

Global Economic Activity Remains Weak

Business Cycle Report of September 2016

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The period of weak growth continues in emerging market economies, and the USA also saw the pace of economic expansion slow in the first half of 2016. In the EU, activity flattened, following the buoyant start early in the year, but remained on a growth path. The Brexit vote in the UK briefly upset financial markets and companies. In Austria, the weakness of global economic activity continues to be a major strain on the export industry, but expanding domestic demand continues to provide a strong stimulus to growth.

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Economic growth in the USA has been weaker than in the EU in the last three quarters. Notably the decline in investment demand has been weighing on overall economic growth. Business surveys do not suggest that activity will accelerate in the near future. Economic activity remains weak also in emerging market economies, but leading indicators point to an improvement in the coming months.

The vote of the British population against staying in the European Union at the end of June 2016 weighed on business sentiment in the UK, but barely dampened confidence overall in the euro area as a whole. Even the depreciation of the pound sterling vis-à-vis the euro did not cause any significant deterioration in assessments. Only Germany saw yet another marked drop in the Ifo Index in August, following a decline already in July. After extremely buoyant growth early in the year and a slowdown in the second quarter, activity there is likely to moderate further going forward.

As expected, economic growth moderated in Austria in the second quarter compared with the first quarter of 2016. While domestic demand continued to support economic activity, net exports dampened the result. However, business cycle surveys as well as WIFO's Leading Indicator point to a further slight acceleration in the pace of activity in the coming months. Employment still grew compared with a year before, but seasonally adjusted data do not show a further month-on-month increase. The number of unemployed also remained flat. In August, the unemployment rate was unchanged from a year before and on a seasonally adjusted basis also roughly corresponded to the rate recorded a month earlier.

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.

1. Lacklustre world trade as an expression of global economic weakness

The world trade indicator published by the Dutch CPB showed a constant decline in global trade activity from the beginning of 2016 onwards until May. This may well be a signal of a slowdown in global economic growth, although the relationship between the two quantities appears to have loosened in recent years.

In addition to weak growth in the USA, many emerging market economies also remain in a difficult situation. Russia's economy continues to suffer from the boycott measures imposed by the EU, and the low price of fossil energy sources dampens foreign exchange proceeds. In Brazil, output contracted in the second quarter of 2016, having decreased already since the beginning of 2015, but the OECD's leading indicator suggests that an improvement is imminent. By contrast, economic growth accelerated in China in the second quarter, while, after a good result at the beginning of the year, the pace of expansion in Japan moderated again somewhat in the second quarter (+0.2 percent).

2. USA sees weak expansion in first half of 2016

Following real growth of merely 0.2 percent quarter on quarter in both the fourth quarter of 2015 and the first quarter of 2016, US GDP, at +0.3 percent in real terms, once again expanded only very modestly in the second quarter of 2016. Hence overall economic growth has been lagging behind the expansion in the EU already for three quarters.

The weakness of the economy is a consequence of the decline in investment demand, notably in the demand for machinery and equipment and buildings. In addition, considerable inventory reduction took place in the second quarter of 2016, with the result that increased demand in some sectors did not result in an expansion of production.

Household consumption meanwhile remained quite robust in the second quarter amid favourable financing conditions and persistent employment growth. The marked decline in the unemployment rate observed since the 2008-09 recession appears to have come to a halt, however: in August 2016, the rate was 4.9 percent, unchanged from June and July, and only slightly lower than a year before (5.1 percent). The consumer confidence surveys conducted by the Conference Board and the University of Michigan bode well for continued dynamism in consumer spending in the coming months.

Industrial production, by contrast, has been subdued for several years and stagnant since the start of 2016. In August, the Purchasing Managers' Index fell again below the expansion threshold – following a gradual pick-up since early in the year. Hence an acceleration of industrial production in the near future is rather unlikely.

US monetary policy keeps the key interest rate at the extremely low level ranging between 0.25 percent and 0.50 percent. The inflation rate was 0.8 percent in July.

3. Brexit vote barely dampens economic activity in the EU

The majority decision of the British people against remaining in the European Union temporarily triggered anxiety in financial and capital markets, with the pound sterling briefly losing around 10 percent of its value vis-à-vis the euro. By contrast, the Purchasing Managers' Index, which portrays the expectations of companies in the euro area, barely showed any reaction.

Economic growth in the euro area and in the EU as a whole was quite brisk in the first quarter, with each region recording GDP growth of 0.5 percent. In the second quarter, the pace of expansion slowed marginally to 0.4 percent in the EU as a whole, and to 0.3 percent in the euro area. Domestic demand has so far stabilised the euro area economy, while global activity weighed on growth until recently. It was not un-

til the second quarter of 2016 that exports grew again vigorously, unaccompanied by equally growing imports.

Household consumption in the euro area keeps growing steadily, albeit modestly, supported by improvements in the labour market. Private consumption expenditure rose by 0.2 percent in the second quarter, following +0.6 percent in the previous quarter. In July, the number of persons unemployed in the euro area was down by about 1 million from a year before, but the unemployment rate still exceeded 10 percent.

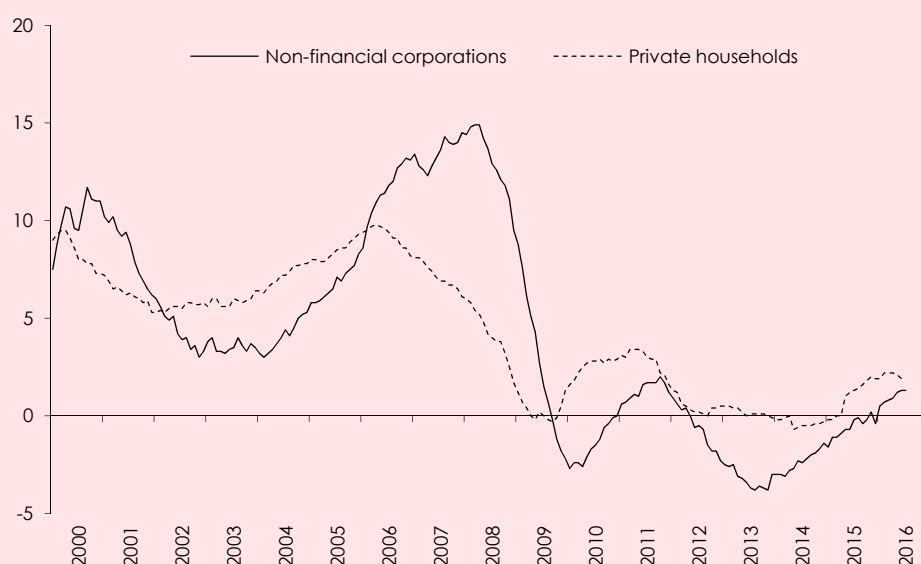
Investment demand is also increasing vigorously, although its growth halted in the second quarter, following strong rates of increase in the previous two quarters. The sizeable pent-up demand for investment resulting from the 2008-09 recession, as well as persistently favourable financing conditions should enable further growth of this component, although the outlook for economic activity remains subdued and confidence regarding future economic developments is being damaged repeatedly (Brexit vote in the UK, attempted coup in Turkey).

Euro area inflation was 0.2 percent in July, marking nearly three years of a rate below 1 percent. The ECB is still trying, by means of non-standard monetary policy measures, to raise the inflation rate to within its target of about 2 percent. To this end, it will continue its monthly purchases in the markets of government bonds and also corporate bonds – purchases of the latter were begun in June 2016 – of 80 billion € altogether at least until March 2017.

These purchases lead to a sizeable growth in money, but recently credit growth in the private sector has also been contributing to increased money creation. The volume of loans to private households has been increasing already since spring 2015, while that of loans to non-financial corporations has been growing again only since the beginning of 2016 (Figure 2).

Figure 2: Outstanding amounts of loans in the euro area

Percentage changes from previous year

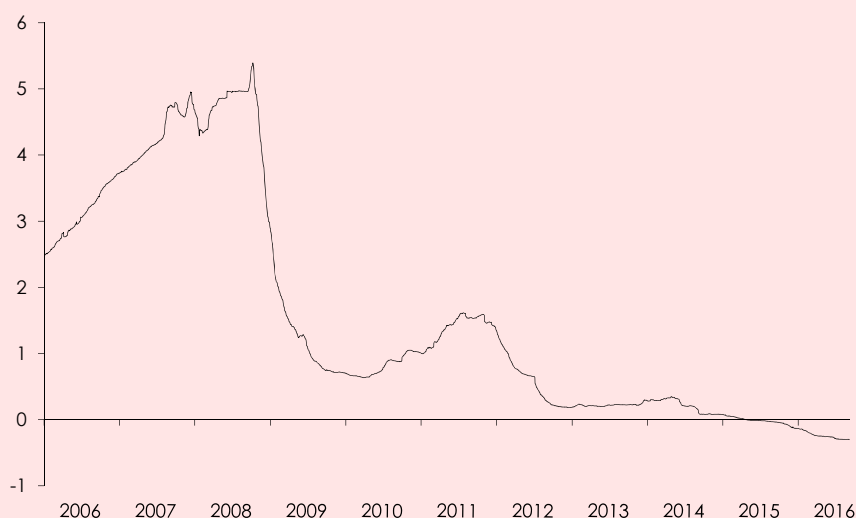


Source: European Central Bank.

This trend reversal of credit volume developments was not confined to a few countries, but was observed in many countries of the euro area. It may in part be attributable to the reduction in financing costs resulting from the non-standard monetary policy measures. Money market interest rates for interbank loans fell further and curbed credit costs (Figure 3).

Figure 3: Three-month Euribor interest rate

In percent



Source: European Money Markets Institute, Macrobond.

The consumer and business surveys conducted after the referendum in the UK on EU membership reflected a deterioration in sentiment, which was largely confined to the UK, however, with consumer sentiment reacting more strongly than business sentiment. By contrast, sentiment indicators for the euro area, which is closely linked with the British economy through external trade, barely moved in July and fell only little in August.

4. German economy losing traction

Following brisk GDP growth of 0.7 percent in real terms in the first quarter of 2016, the expansion in Germany slowed to 0.4 percent in the second quarter. Evidence presented in the Ifo Business Survey signals a further loss in momentum.

The brisk increase in domestic demand could not be sustained in the second quarter. Net exports, by contrast, contributed increasingly to growth. Private and public consumption were subdued, while machinery and equipment investment and construction investment even declined compared with the previous quarter.

According to the Ifo survey conducted among German companies, the business climate deteriorated slightly in July and markedly in August. The deterioration extended to both the assessment of the current situation and the appraisal of future developments and was observed in all sectors except construction. The outcome of the British vote in favour of leaving the European Union may have played a role here, for the UK is Germany's third most important sales market for goods, after the USA and France.

Until June, the German industrial production index remained as subdued as in recent years. In August, the industrial confidence indicator fell slightly to the level seen in the first half of the year. Developments in the labour market and the public sector remain positive: the unemployment rate fell further in July, reaching a record low of 4.2 percent, and public budgeting data bode well for yet another surplus in 2016.

5. Domestic demand stimulates economy in Austria

After +0.4 percent in the first quarter of 2016, economic growth slowed marginally to 0.3 percent in the second quarter. The growth momentum in the first half of the year came in stronger than a year before. The brisker growth is driven by increased con-

sumption and the pick-up in investment demand observed already since last year. Both government consumption (second quarter of 2016 +0.2 percent in real terms) and private consumption (+0.3 percent) reflect the increased spending on refugees. In addition, the growth in spending on consumer durables since the beginning of 2016 points to possible positive effects of the tax reform that became effective on 1 January 2016. The number of motor vehicle registrations, especially of motorcycles, also rose sharply in August.

Retail trade (excluding motor vehicle trade) benefited less than expected from this again somewhat more lively growth in private consumption in the first half of 2016. Real sales increased by a mere 1.4 percent during this period, despite the fact that there were two more selling days (including one leap day) than a year before.

Gross fixed capital formation gradually gained momentum already in the course of 2015 and expanded at a particularly brisk pace in the first and second quarters of 2016 (+1 percent each in real terms, quarter on quarter).

Owing to weak global activity, the export industry is expanding only little. The value of merchandise exports increased by a mere 1.2 percent in the first half of 2016 compared with the same period a year before, with the persistent decline in foreign trade prices dampening the result. The trade with EU countries (+1.9 percent) had a stabilising effect, while merchandise exports to third countries shrank (-0.4 percent).

Austria's industrial production continues its moderate upward trajectory only very sluggishly, owing to the weak external environment. In June, the industrial production index was only 0.1 percent higher than the month-earlier reading. Compared with a year before, the increase was 0.9 percent, while the cumulative half-year increase was 2.2 percent compared with the same period a year before.

The weak export activity is also reflected in the sales figures for the production sector: sales from January to May 2016 decreased by 2.2 percent compared with the same period a year before, according to Statistics Austria. Producer prices are declining further and are therefore dampening sales proceeds, though.

In WIFO's Business Cycle Survey of August 2016, firms assessed their present business situation slightly more positively, while they were somewhat more pessimistic regarding the business outlook. However, both indicators were still clearly in expansionary territory, suggesting that the moderate expansion may continue in the coming months. Similarly, the Bank Austria Purchasing Managers' Index declined slightly in August, but continues to indicate growth in the near future.

WIFO's Leading Indicator, which is made up by a number of sub-components, also points to ongoing growth; it rose slightly further in August.

5.1 Commercial and office building construction drives construction activity

Construction investment, at +1.1 percent in real terms quarter on quarter rose at a particularly brisk pace in the first quarter of 2016, owing to the mild weather. In the second quarter, the expansion lost some momentum (+0.9 percent). Especially non-residential construction investment grew briskly, while lower gains were recorded for residential construction investment. Other building construction, which also includes commercial and office building construction, is currently the main driver of construction activity. Civil engineering activity declined.

According to Statistics Austria, sales in the construction industry rose by 4.7 percent between January and May 2016, compared with the same period a year before; employment exceeded the year-earlier level by 1.4 percent in the first half of the year, according to the Federation of Austrian Social Security Institutions.

5.2 Only little corporate demand for loans despite favourable financing conditions

Financing conditions for companies improved further. Interest rates for newly granted business loans of up to 1 million € (weighted according to different periods of maturity) had already dropped to close to 2 percent in recent years, and in July

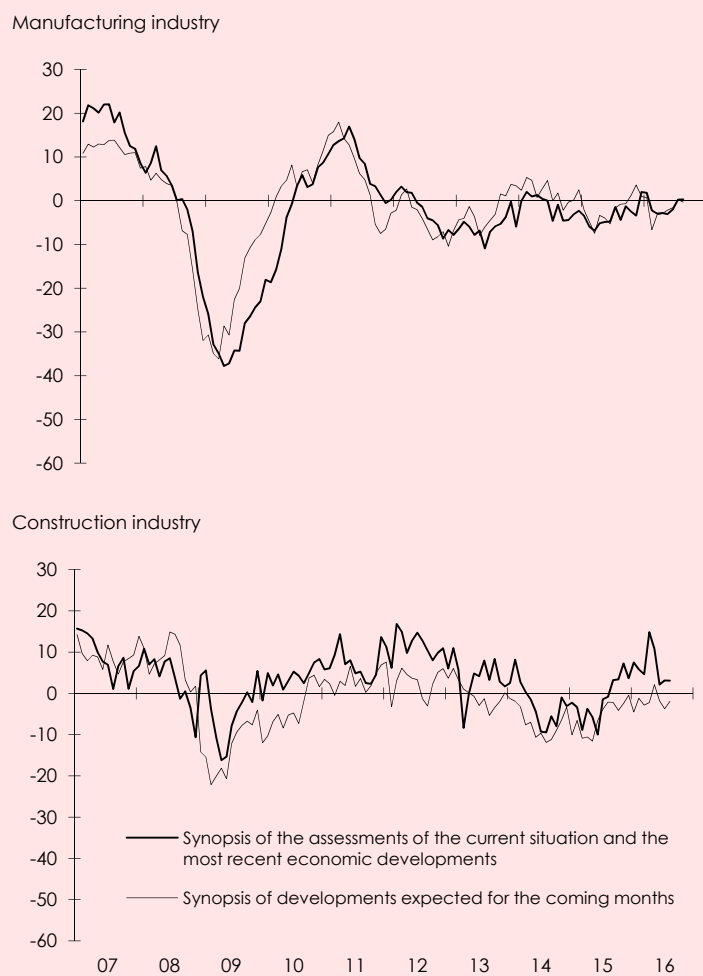
Since the end of 2015, domestic activity has been generating momentum for brisker economic growth in Austria. Consumption is benefiting from the tax reform and the spending on refugees. Investment demand is also increasing, supported by the need to modernise the capital stock and by favourable financing conditions.

stood at 1.93 percent, according to OeNB (Austrian National Bank). The three-month interest rate for interbank loans fell to -0.3 percent in August.

Despite these extremely supportive financing conditions, Austrian firms' demand for loans barely increased. In the first quarter of 2016, the volume of loans to Austrian non-financial corporations amounted to 133,800 million € – almost unchanged since the end of 2015 – according to OeNB. This likely reflects firms' low demand for loans rather than a restrictive lending practice by banks.

Figure 4: Results from the WIFO Business Cycle Survey

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

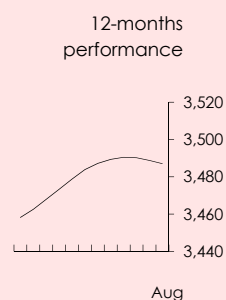
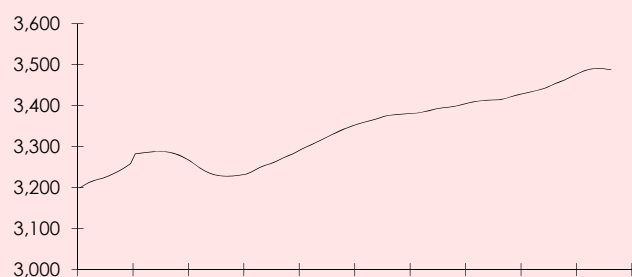


Source: WIFO Business Cycle Survey. Data refer to index points (percentage points) between +100 and -100. Values above 0 imply positive expectations, values below 0 indicate negative expectations.

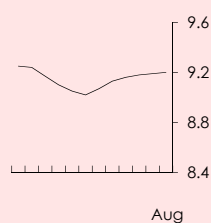
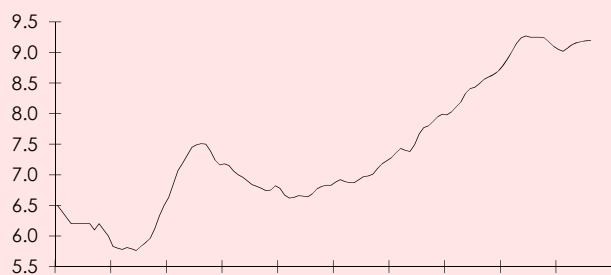
In WIFO's Business Cycle Survey of August 2016, only 21 percent of the surveyed companies stated to basically have had a need for a bank loan in the previous three months. Hence the demand for loans was similarly low as in the past (2013: 25 percent). Most recently it was 20 percent in the services sector, 22 percent in manufacturing, and 27 percent in construction. 21 percent of small companies with fewer than 50 employees had demand for a loan, while the same applied to 24 percent of medium-sized companies with a staff ranging between 50 and 249, and to 23 percent of big companies with a staff of 250 or more. 55 percent of the companies in need of a loan were granted the expected amount of the loan and on the expected terms; 18 percent had to accept cuts in the loan amount and/or less favourable terms, and 27 percent were rejected by the bank, or were not granted acceptable terms, or relinquished their plan to apply for a loan as they saw no chance of success.

Figure 5: Key economic indicators

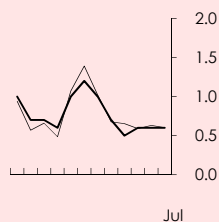
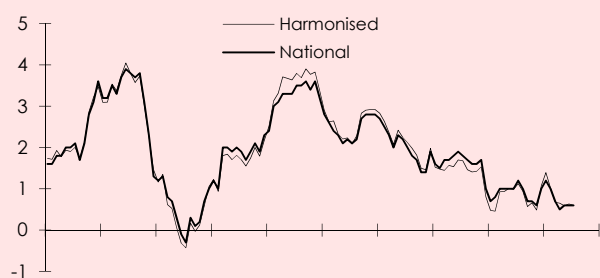
Persons in active dependent employment¹, (1,000), seasonally adjusted



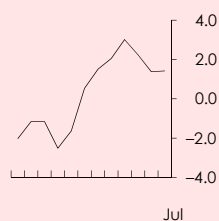
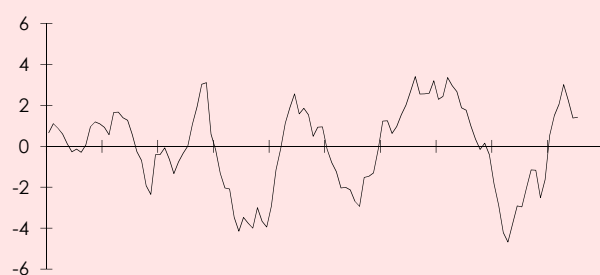
Unemployment rate, traditional Austrian method², seasonally adjusted



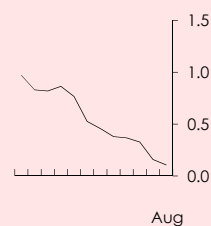
Consumer prices, year-to-year percentage changes



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.

While the majority of firms believe that banks are currently restrictive in their lending, they also believe that they are considerably less restrictive than five years ago.

Only the public sector currently enjoys even more favourable financing conditions. At the beginning of September, for instance, the federal government was able to raise funds by way of newly issued bonds with a maturity of seven years at a yield of –0.32 percent. Hence this low interest rate environment continues to considerably reduce the government's debt service burden.

In real terms, many interest rates are clearly in negative territory. Thus, the inflation rate stood unchanged at 0.6 percent in July. This further reduces the real value of the credit and/or loan debt, respectively, as well as that of future interest payments, and makes external financing extremely attractive.

The EU-wide harmonised inflation rate, at 0.6 percent remained above the euro area average of 0.2 percent in July. According to Statistics Austria, inflation in the "restaurants and hotels" category accounted for almost all of the divergence. Prices of both services related to the provision of food and drink and accommodation services increased vigorously compared with a year before. Lower fuel prices, by contrast, continued to put downward pressure on inflation.

Inflation in Austria remains above the euro area average.

5.3 Unemployment rate stagnant

While in June 2016 the number of persons in dependent active employment still exceeded the year-earlier figure by 55,000 (+1.6 percent), the increase slowed to 33,100 (+0.9 percent) in July and – according to provisional calculations – remained small also in August (+0.9 percent).

The number of unemployed persons is also barely changing at present. This goes for both the year-on-year comparison and the comparison with the previous period based on seasonally adjusted figures. As a month before, around 430,000 persons were registered as unemployed with the Public Employment Service AMS (including persons in training) in August. Compared with a year before, the number increased by 1 percent.

Seasonally adjusted data have been showing for several months that employment growth is losing momentum. Compared with a year before, an increase is still noticeable, but it is also already moderating.

The unemployment rate according to the national method of calculation was 8.3 percent in August, unchanged from a year before. Including persons in training, the rate increased slightly to 9.7 percent, after 9.4 percent and 9.7 percent, respectively. The unemployment rate according to Eurostat declined slightly from 6.1 percent to 6.0 percent in July; the figure for August is not yet available.