

Christian Glocker

## Austrian Economy Improving at Start of the Year

### Business Cycle Report of May 2016

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Austria's real gross domestic product rose by 0.4 percent, quarter on quarter, in the first quarter of 2016, according to WIFO's latest Flash Estimate. Hence economic activity, after growing at a robust pace last year, continues to gather speed. However, the varying picture painted by leading indicators at least does not suggest any stronger upward trend for the second quarter.

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The global economy has been stabilising since the beginning of the year, following a marked slowdown in output growth at the end of 2015. A growing amount of evidence, especially in a number of advanced economies, is signalling an end of the economic weakness. Emerging market economies, notably the large Asian and Latin American economies, saw growth momentum slow once again in the fourth quarter of 2015. Global economic growth is expected to gradually pick up in the coming months, receiving a boost from ongoing robust growth prospects for major advanced economies and the easing of the deep recessions underway in a number of large emerging market economies. This is also suggested by the renewed increase in oil prices.

Following modest, albeit robust growth last year, the Austrian economy continued its recovery in the first quarter of 2016. This development was driven by domestic demand: owing to the strong momentum of government consumption, total consumption rose by 0.3 percent in real terms; economic growth was also supported by increased investment. Net exports did not contribute significantly.

The homogeneous development of the components of domestic demand on the one hand and output of the individual economic sectors on the other suggests that economic activity may gather momentum of its own in the coming months. But at present only a few leading indicators point to a lasting improvement, while others rather suggest a continuation of the sluggish trend seen in previous quarters.

The tepid recovery of the Austrian labour market has recently begun to falter: employment and the number of job vacancies did increase also in April, but unemployment has recently been rising again on a month-on-month basis (in each case based on seasonally adjusted data).

## 1. Global economy stabilising

Economic activity has been stabilising globally and notably in several advanced economies since the beginning of the year, following a marked slowdown in growth at the end of 2015. The pace of the recovery will likely be slower than assumed, as the growth momentum is still fragile. Growth in emerging market economies remains weak.

In the USA, the robust expansion seen until the third quarter of 2015 slackened considerably in the fourth quarter of 2015 and the first quarter of 2016. In Japan, the economy also lost momentum; GDP contracted once again in the fourth quarter. Among major advanced economies outside the euro area, only the UK registered continued stable growth in the second half of 2015. Economic activity slowed again also in emerging market economies in the fourth quarter of 2015, not least owing to the shift in focus on domestic demand in China. Latin America was affected by the deep recession in Brazil, in addition to the negative impact of low commodity prices on activity in commodity-producing countries.

Global economic growth should stabilise now: the Purchasing Managers' Index (PMI, source: Markit) for global all-industry output rose in March, and the sub-index for manufacturing also picked up and now lies again noticeably above the growth threshold. The PMI rose for both advanced and emerging market economies, but its development was highly heterogeneous across these groups of countries.

Global economic activity is receiving a boost from continued robust growth prospects for major advanced economies and the projected steady easing of the deep recessions underway in a number of large emerging market economies, notably Brazil and Russia. Persistently low interest rate levels, improving labour market conditions and growing consumer confidence support the prospects for advanced economies. By contrast, the outlook for emerging market economies is surrounded by great uncertainty: the persistent deceleration of growth in China may spread to other emerging economies (especially in Asia). Commodity-exporting countries meanwhile have to make further adjustments owing to the low commodity prices, although some prices (e.g., crude oil) have again recovered slightly.

The sharp fall in commodity prices in 2015 was mostly attributable to a vigorous increase in supply; in the second half of 2015, however, the downward pressure is also increasingly being associated with demand factors. Different kinds of price shocks can have greatly diverging consequences for the global economy. The largely supply-related decline in commodity prices in the second half of 2014 and at the beginning of 2015 likely had a positive impact on total global GDP, on the one hand through a redistribution of income from commodity-producing to commodity-consuming countries with a higher marginal propensity to spend and, on the other hand, through profitability increases owing to a decrease in input costs, which boosted investment activity and thus the aggregate supply of net commodity importers. Since most advanced economies are net commodity importers, they benefited noticeably from the low commodity prices, for instance through increases in purchasing power.

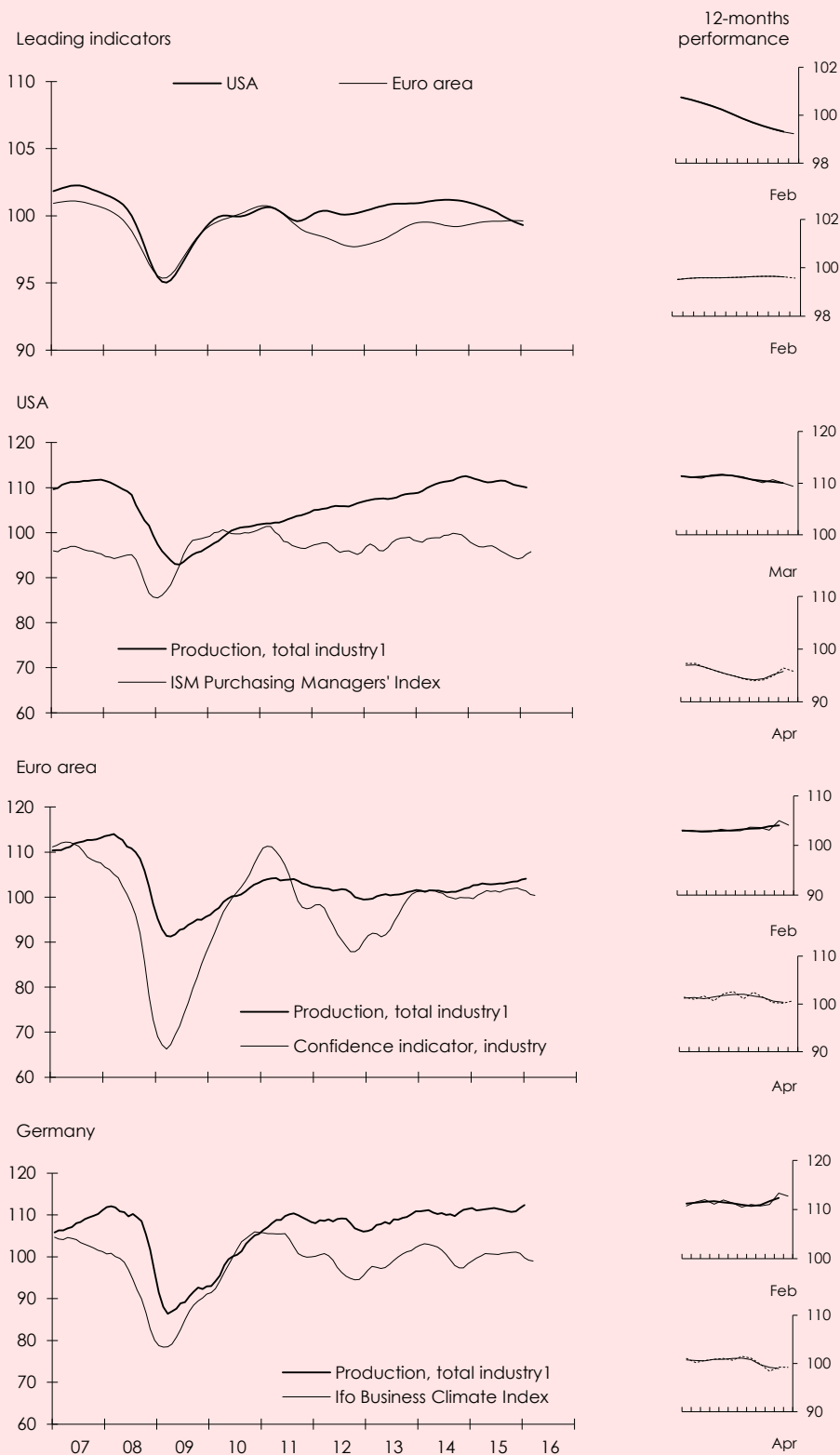
With the gradual shift to a more strongly demand-related decline in commodity prices in the second half of 2015, the weakening of external demand is assumed to largely shatter the positive effects of cheaper commodity prices on activity in advanced economies, as it has increasingly reflected sluggish global economic growth. Most emerging market economies – except China and the majority of East Central European countries, for instance – are net commodity exporters. In these countries, the low commodity prices act like a negative terms-of-trade shock. This results in substantial income losses, which considerably dampen activity in these countries and, owing to trade linkages, also impair developments in advanced economies. Given that the effect of the increase in purchasing power and the effect of a weakening of external demand act reversely, low commodity price levels have no longer had any major impact, especially recently, on activity in advanced economies.

*Low commodity price levels are weighing on economic activity in commodity-producing countries.*

As the continuous price decline is affecting commodity-exporting countries more severely than assumed, the restrictive economic policy required for overcoming growing fiscal imbalances may dampen domestic and external demand even more strongly.

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.

## 1.1 USA: upswing intact despite dip in activity

The upswing in the USA has weakened considerably of late; real gross domestic product grew by a meagre 0.3 percent quarter-on-quarter in the fourth quarter of 2015, a substantial slowdown from the second and third quarters. In the first quarter of 2016, growth came in at only 0.1 percent, reflecting a largely stagnant economy. This development was determined by both domestic and foreign factors: private consumption growth flattened, due to, among other things, weaker increases in households' real disposable incomes compared with previous quarters. Government demand did not rise further in the fourth quarter of 2015, and even declined slightly in the first quarter of 2016. Winter saw substantial cutbacks in investment, early in 2016 especially in equipment investment. Owing to the decline in exports, net trade also acted as a drag on overall economic growth.

The slowdown in the first quarter had already been suggested previously by a number of leading indicators. But the upswing in the USA is intact, despite the dip in economic activity. This is reflected by, among other factors, continued robust momentum in the labour market and output-side indicators such as the Purchasing Managers' Index, which point to output growth in the coming months. Hence, GDP growth is expected to accelerate in the course of 2016.

In December 2015, the Federal Reserve initiated a turnaround in interest rate movements by raising the target range for the federal funds rate by 25 basis points; since then, the Open Market Committee has kept the key interest rate steady. The reasons given for the restraint exercised with respect to further interest rate steps include the economic slowdown and the most recent increase in financial market volatility.

## 1.2 Domestic demand driving economic activity in euro area

Economic growth accelerated again in both the euro area and the EU as a whole in the first quarter of 2016 (according to Eurostat's flash estimate, real GDP +0.6 percent and +0.5 percent, respectively, after +0.3 percent and +0.4 percent, respectively, in the fourth quarter of 2015). Especially private consumption growth appears to have driven activity in a number of euro area countries, for instance in France and Spain.

Inflation remains extremely low in the euro area: in March, the price level as measured by the HICP remained unchanged compared with a year before, and in April consumer prices fell slightly by 0.2 percent, according to a first estimate by Eurostat. Notably energy prices declined further in April, whereas those for services increased. The spread between inflation rates observed among euro countries has grown further since the beginning of the year: in March, Belgium recorded the highest inflation rate (1.6 percent), whereas Spain and Cyprus registered negative rates (-1.0 and -2.2 percent, respectively).

The economic recovery is increasingly having a positive effect on the euro area labour market. In March, the number of persons unemployed was down by around 230,000 compared with the previous month, and by almost 1.5 million compared with a year before. The seasonally adjusted unemployment rate fell from 10.4 percent in February to 10.2 percent – the lowest reading since August 2011. But the divergence across euro area countries remained significant: the lowest rate was recorded by Germany (4.2 percent) in March, the highest by Spain (20.4 percent) and Greece (January 24.4 percent).

The picture painted by leading indicators is definitely positive overall. The improvement in the Economic Sentiment Indicator (ESI) for the euro area resulted from increases in the confidence indicators for consumers and all economic sectors except retail trade. The confidence indicators for services and construction improved significantly, while those for the manufacturing sector and for consumers increased only little. Among the large euro area economies, the ESI rose considerably in Italy and the Netherlands and only little in Germany but declined in France and Spain.

*Most leading indicators paint a cautiously positive picture for both the euro countries and the EU as a whole.*

The ESI for the EU as a whole improved less than that for the euro area, primarily as a result of the deterioration in sentiment in the UK. In Poland, the second-largest EU economy outside the euro area, however, the ESI followed a vigorous upward trend.

## 2. Austria sees pick-up in economic activity at start of the year

Real GDP rose by 0.4 percent quarter on quarter in Austria in the first quarter of 2016 (after +0.3 percent in the fourth quarter of 2015), while unadjusted year-on-year growth came in at 1.3 percent. Hence economic activity gathered speed at the beginning of 2016.

Growth was driven by domestic demand, both consumption and investment increased. Private consumption (including consumption of private non-profit organisations) grew by 0.2 percent quarter on quarter. Total consumption rose by 0.3 percent, owing to the increase in government consumption. The demand for gross fixed capital formation (investment in plant and equipment and construction investment) grew by 0.4 percent, a rate similar to those seen in previous quarters. Construction investment also increased, after a phase of weakness in the previous two years. The contribution of net trade to growth was dampened by the increase in imports: while exports rose by 0.8 percent, imports expanded by 0.9 percent. Notwithstanding flat global economic activity, Austria's foreign trade thus remained robust also in the first quarter of 2016, with increasing goods as well as services exports.

The economic upswing appears to be broadening. Since the second quarter of 2015, overall economic growth has been driven not only by private and government consumption, but increasingly also by investment. The expansion has also spread to all economic sectors on the supply side. For instance in manufacturing, value added rose by 0.6 percent quarter on quarter. Value added also increased in construction (+0.2 percent) and in the services sector (wholesale and retail trade and motor vehicles, transport, hotels and restaurants as well as information and communication +0.2 percent each, financial and insurance activities as well as real estate and renting activities +0.4 percent each).

The well-balanced development of the components of domestic demand and of the supply side suggest that the upswing will increasingly gather momentum of its own in the coming months. As particularly the homogeneous development of output in the economic sectors suggests, brisk increases in demand in individual industries could again gain significance as important drivers of overall economic growth. Leading indicators have only partly been signalling a robust upswing so far.

### 2.1 Businesses remain sceptical regarding economic activity

While a number of economic indicators are providing positive signals, others rather suggest a continuation of the subdued momentum observed in recent months. In WIFO's Business Cycle Survey of April, firms assessed the current situation somewhat more positively than a month earlier, but once again judged the outlook for the coming months more unfavourably.

In April, the index for the economy as a whole of firms' assessments of the current situation, at 2.7 points, exceeded the reading a month before. This increase was largely fuelled by the construction sector, where the index rose by 10.0 to 14.5 points. By contrast, firms' assessments of the current situation in manufacturing, despite a slight improvement (+0.4 points), were mostly negative and below average (-2.6 points). In the services sector, the index remained in positive territory at 3.6 points, but was also below average compared with the sectoral development.

Firms' assessments of the economic outlook have been signalling a weakening of momentum since November 2015, which continued to some extent in April. The index of business expectations declined compared with March and lay on the zero line separating optimistic from pessimistic assessments. The results for the individual sectors also indicate scepticism among Austrian firms regarding the business outlook. In manufacturing, the expectations index improved a little in April, but remained negative on balance. In construction, business expectations remained in negative

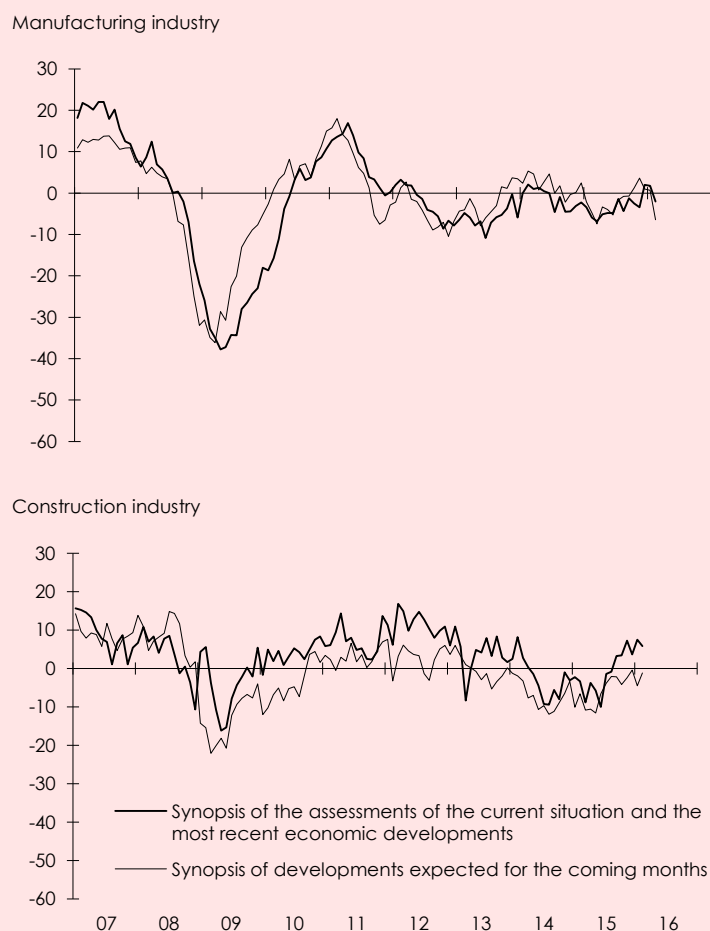
*Following modest, albeit robust expansion last year, economic activity in Austria continued to gather speed in the first quarter of 2016. Growth was driven by domestic demand: both consumption and investment increased further. Net exports, by contrast, did not contribute to GDP growth.*

*The picture painted by leading indicators differs greatly at the sectoral level; firms' assessments of future prospects are rather sceptical.*

territory, despite a small improvement. In the services industries, the index continues to show a trend towards weakening.

Figure 2: 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 Bank Austria Purchasing Managers' Index (PMI) fell to 52.0 points in April. Hence the upswing observed since April 2015 in the Austrian industry continues, albeit at a somewhat slower pace. Production increased further in April owing to rising domestic orders. While for the first time in several months the production increase is reflected in employment gains, firms' scepticism regarding the sustainability of the recovery becomes apparent in a very cautious stock management.

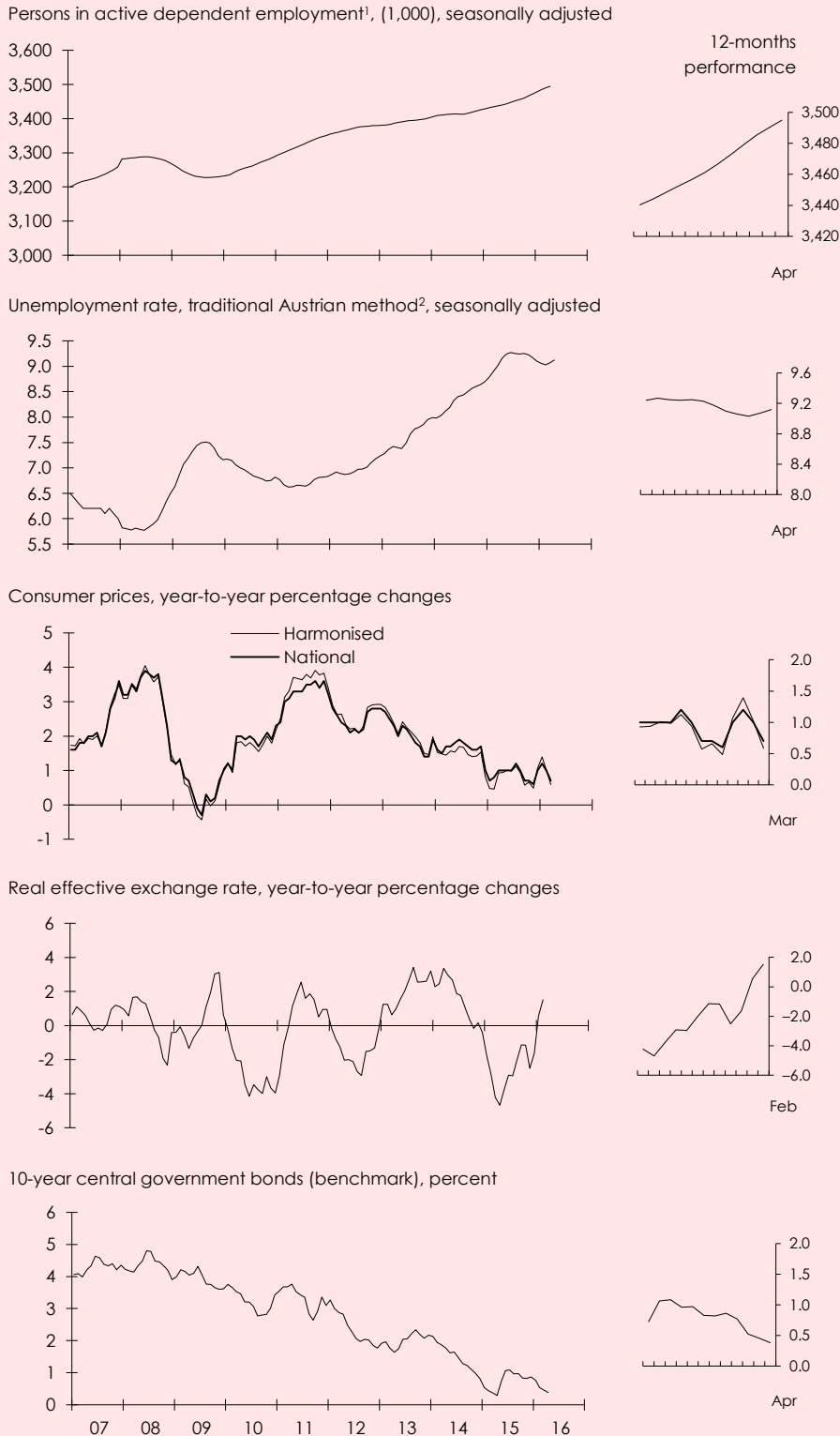
WIFO's Leading Indicator, having fallen steadily in recent months, stagnated in April. Hence the economic outlook, while not deteriorating further, did not brighten either. The indicator rather points to a continuation of the subdued momentum seen in recent months.

## 2.2 Inflation remains contained

Consumer prices rose by 0.7 percent in March 2016 (February +0.1 percent), according to calculations by Statistics Austria; this was the lowest inflation rate recorded since November 2015 (+0.6 percent). HICP inflation came in at 0.6 percent. The decline in the inflation rate was mainly due to the drop in fuel prices, which accelerated in March (excluding fuels, CPI inflation would have stood at 1.3 percent), but also to markedly slower price increases in the "household equipment and routine maintenance of the house" expenditure category. As in the past, prices in the "res-

restaurants and hotels" expenditure category posted an above-average increase (+3.3 percent), especially those of services related to the provision of food and drink (+3.4 percent; accommodation services +2.1 percent). Rents continued to rise vigorously at +2.7 percent recently; however, this was counterbalanced by the decline in energy prices for households (-3.7 percent).

Figure 3: Key economic indicators



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.



### 2.3 Labour market recovery despite recent setbacks

Employment continued to grow markedly in April. The number of persons in dependent active employment rose by 4,800, month on month, on a seasonally adjusted basis, and by 52,000 or 1.5 percent compared with a year before. The demand for labour of industrial enterprises may rise further in the coming months. This is suggested by the increase to 52.2 points of the employment sub-index of the Bank Austria Purchasing Managers' Index. While in 2015 jobs had been lost in the Austrian industry, slight employment gains were registered in the early months of 2016. In 2016, positive order book levels may for the first time in two years allow employment increases in the industrial sector.

The number of persons unemployed rose slightly on a year-on-year basis (+1,900 or +0.5 percent, respectively), while on a seasonally adjusted basis it has been stagnating at a high level for several months. Hence the unemployment rate remains unchanged at 9.1 percent.

The number of job vacancies registered with the AMS (Public Employment Service) is rising due to the pickup in activity. However, given the ongoing brisk rise in the labour supply, the slightly more favourable economic development is not yet reflected in falling unemployment.

*The tepid recovery of the Austrian labour market observed since last year has recently experienced setbacks. Employment has continued to rise, and so has the number of job vacancies, but unemployment has also posted slight increases recently (in each case on a seasonally adjusted basis).*