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Austrian Economy Barely Grew in Third Quarter

Business Cycle Report of November 2008

Austria's real GDP grew at a seasonally and working day adjusted quarterly rate of 0.1 percent in the third quarter of 2008 (after +0.3 percent in the second quarter). Compared with the same period last year, the growth rate was 1.5 percent (second quarter +2.2 percent). Notably the export-driven manufacturing sector has been experiencing a marked slowdown on the back of the global downturn. While activity in the construction sector has also begun to slacken, tourism is still providing a stimulus. Leading indicators suggest that the downturn in the industrial sector is likely to accelerate in the fourth quarter.

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Economic growth in Austria has lost momentum in the course of this year. In the third quarter, the seasonally and working day adjusted quarter-on-quarter rate fell to just +0.1 percent. The slowdown is particularly apparent in the manufacturing sector which usually reacts quickly to the business cycle: value added declined by 0.7 percent compared with the previous quarter. A similarly high decline was last recorded in 2001. The construction industry, a pillar of the slackening economy in the first half of 2008, posted only a marginal increase in value added compared with the previous quarter (+0.2 percent). While the demand for investments in machinery and equipment fell, household expenditure growth remained stable (+0.3 percent quarter-on-quarter).

Export demand declined due to the setback in economic activity in key sales markets (–0.3 percent quarter-on-quarter). The downturn in the EU intensified in the third quarter, following contraction of some large European economies already in the second quarter. Euro area industrial production has been shrinking since May, compared with the same period a year earlier, and uncertainty stemming from the financial crisis has been dampening consumer and investment demand. In October, the European Commission's Confidence Indicator fell to its lowest level since the recession in 1993. Real GDP growth in the USA declined by 0.1 percent in the third quarter, compared with the strong second quarter (+0.7 percent). Wealth losses in real estate and financial markets depressed household consumption expenditure, which in the previous quarter had still been bolstered by the expansionary fiscal policy. With real estate prices falling further, residential investment declined again in the third quarter.

The latest WIFO business survey suggests that the downturn in Austria's industrial sector will intensify further in the fourth quarter. In October, the companies reporting a fall in production for the first time in five years outnumbered those reporting an increase. Capacity utilisation sank to below 82 percent, a decline by 4 percentage points from 18 months before. Notably weak domestic and foreign demand is affecting companies, while currently only around 1 percent of the surveyed firms state that financing problems stemming from the financial crisis are hampering production.

The depreciation of the euro against the dollar suits Austrian export-oriented companies. The price of oil has also eased lately. After \$ 140 in July, one barrel of Brent crude oil was traded at \$ 60 at the beginning of November. Inflationary pressures

exerted by the costs for fuel and heating oil eased accordingly. At 3.7 percent, the inflation rate was nevertheless relatively high in September. In the context of higher inflation and the current economic downturn, the bargaining partners negotiating a pay round for the metal industry agreed on a pay rise of 3.8 percent for actual wages (+3.9 percent for minimum wages). In addition, a one-off payment linked to the operating result of € 100 to € 250 was agreed.

Table 1: Flash estimates of quarterly national accounts

	Second quarter	2007 Third quarter	Fourth quarter	First quarter	2008 Second quarter	Third quarter
Adjusted for seasonal and working day effects, percentage changes from previous quarter, volume						
<i>GDP, expenditure approach</i>						
Final consumption expenditure						
Households ¹	- 0.1	+ 0.3	+ 0.4	+ 0.3	+ 0.3	+ 0.3
General government	- 0.1	+ 1.6	+ 0.8	- 2.3	+ 2.5	- 1.0
Gross capital formation	+ 0.6	+ 0.6	+ 0.6	+ 0.8	+ 0.9	+ 0.9
Exports	+ 2.1	+ 1.7	+ 1.1	+ 0.6	+ 0.3	- 0.3
Imports	+ 1.5	+ 1.7	+ 0.9	- 0.7	+ 0.5	- 0.2
Gross domestic product	+ 0.7	+ 0.6	+ 0.6	+ 0.5	+ 0.3	+ 0.1
Agriculture, forestry	- 0.3	+ 1.4	+ 1.3	- 0.0	- 0.9	- 1.2
Industry, including energy	+ 0.9	+ 1.4	+ 1.7	+ 0.7	- 0.2	- 0.5
Construction	+ 0.4	+ 0.3	+ 0.3	+ 0.4	+ 0.2	+ 0.2
Wholesale and retail trade; repairs; hotels and restaurants; transport, communication	+ 0.6	+ 0.6	+ 0.5	+ 0.5	+ 0.4	+ 0.4
Financial intermediation; real es- tate, renting and business activities	+ 0.8	+ 0.9	+ 0.6	+ 0.3	+ 0.3	+ 0.5
Other service activities	+ 0.2	+ 0.3	+ 0.4	+ 0.2	+ 0.3	+ 0.4
Taxes on products	+ 0.5	+ 0.4	+ 0.4	+ 0.5	+ 0.5	+ 0.5
Subsidies on products	+ 1.1	+ 1.0	+ 0.8	+ 0.6	+ 0.7	+ 0.8
Percentage changes from previous year						
Gross domestic product, volume	+ 3.2	+ 2.7	+ 2.6	+ 2.8	+ 2.2	+ 1.5

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

The momentum in the labour market has also weakened as a result of the slowdown in economic activity. While employment growth has slowed in the course of the year (October +1.9 percent year-on-year, +0.1 percent quarter-on-quarter), the seasonally adjusted number of unemployed persons rose by 0.3 percent month-on-month. In October, a total of 202,800 job seekers were registered, the unemployment rate remained unchanged at 5.9 percent (seasonally adjusted) according to the Austrian method of calculation.

Global economic activity is weakening further as a result of the financial crisis¹. In the USA, real GDP declined by 0.1 percent in the third quarter relative to the very good result in the preceding quarter. Personal consumption expenditures, which in the second quarter had been stabilised by the expansionary fiscal policy, fell by 0.8 percent in the third quarter. The spending restraint by consumers is reflected in particular in the decline in demand for durable consumer goods (-3.7 percent quarter-on-quarter), automotive sales dropped sharply.

In the USA, the spillover of the financial crisis to the real economy has now become visible also in a sizeable decline in the level of capacity utilisation in the industrial sector (third quarter 78.2 percent, compared with 81.3 percent a year before). Notably the industrial and construction sectors have been reducing staff in recent months. The unemployment rate rose from 6.1 percent in September to 6.5 percent in October. In February it had still been 4.8 percent.

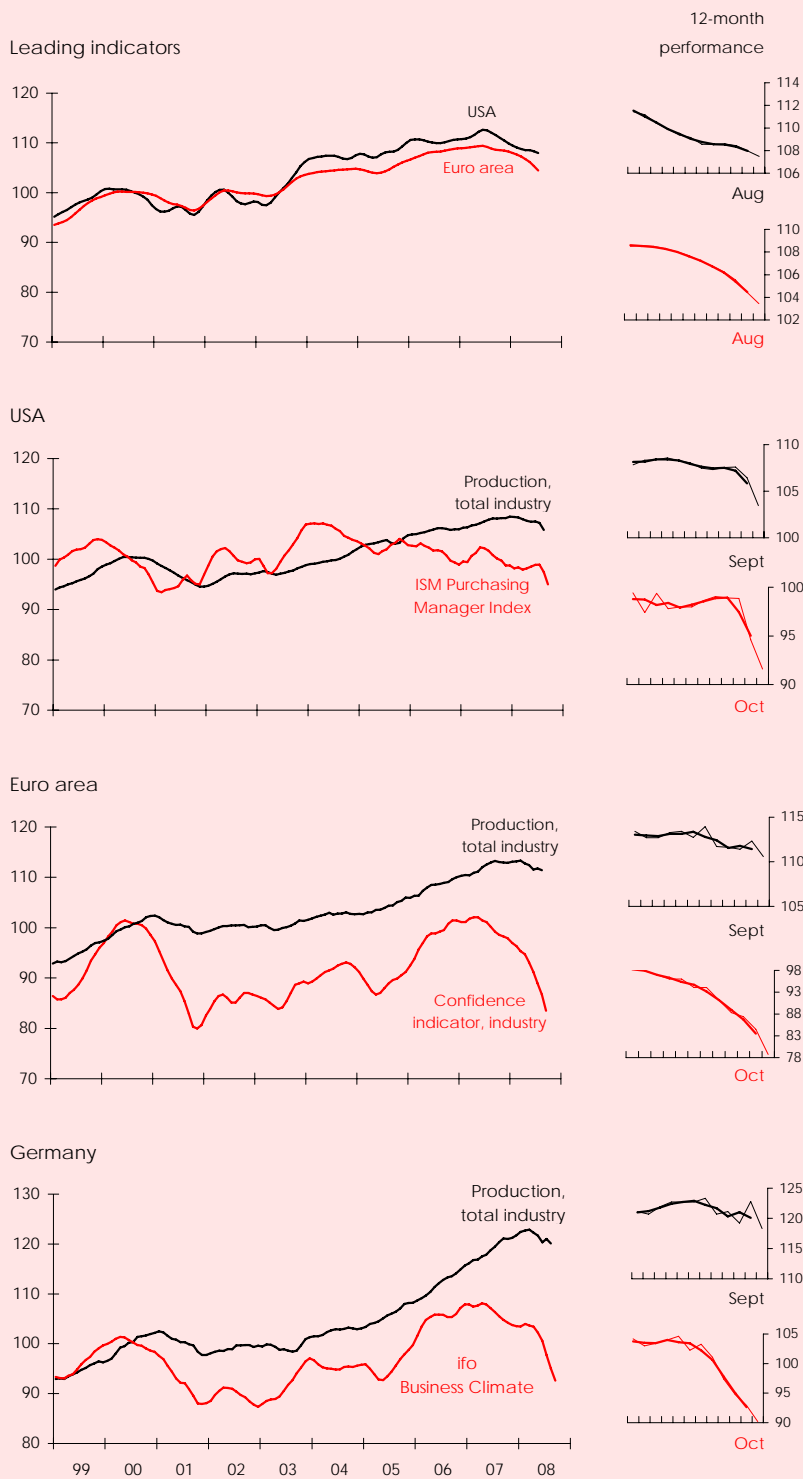
Steep downturn in the USA and in Europe

US real GDP contracted as consumer and investment demand fell. Economic activity deteriorated further also in the EU in the third quarter.

¹ Ederer, St., Marterbauer, M., Schulmeister, St., Walterskirchen, E., Zwickl, K., "Finanzkrise löst weltweiten Konjunkturreinbruch aus", WIFO-Monatsberichte, 2008, 81(11), http://www.wifo.ac.at/www/jsp/index.jsp?fid=23923&id=34401&typeid=8&display_mode=2.

Figure 1: International business climate

Seasonally adjusted, 2000 = 100, 3-month moving average



Source: European Commission, Deutsche Bundesbank, ISM (Institute for Supply Management™), ifo (Institute for Economic Research, Munich), OECD.

The EU has also seen economic activity weaken noticeably. Since May 2008, euro area industrial production remained 1 percent, on average, below the level seen a year earlier. Evidence from the European Commission's most recent survey suggests a further deceleration in industrial activity; in the fourth quarter, capacity utilisation in the manufacturing sector fell below its long-term average (to 81.6 percent; average since 1990: 82 percent). Confidence in the economic situation in the euro area and the EU as a whole is currently at the lowest level seen since 1993, with sentiment hav-

ing deteriorated in all countries and across all sectors, but especially in the large EU countries (France, Italy, Great Britain, Poland and Germany). Apart from industry and construction, the confidence indicators of the European Commission Business Survey posted a drastic fall also in the services sector.

In this critical situation, the most recent decline in the oil price and the depreciation of the euro against the dollar constitute a relief for companies in the euro area. With one barrel of oil trading at \$ 60 at the beginning of November, the crude oil price has already more than halved from its peak at \$ 140 per barrel in July. The euro exchange rate fell from its all-time high of \$ 1.58 in July 2008 to \$ 1.28, thus dampening the impact of the dramatic drop in the crude oil price based on euro prices. The crude oil price reduction has put a brake on inflation; Eurostat's flash estimate for the euro area shows inflation to have fallen from 3.6 percent in September to 3.2 percent in October.

With inflationary pressures easing, the ECB has room for expansionary fiscal policy measures aimed at stabilising the real economy and financial markets. In the space of a month, the ECB cut its key interest rate in two steps by a total of 100 basis points to 3.25 percent.

The seasonally adjusted unemployment rate has been rising again since spring; in September it remained unchanged from the preceding month (7.5 percent of the labour force).

Austria's real GDP grew at a seasonally and working day adjusted quarterly rate of 0.1 percent in the third quarter of 2008 (following +0.3 percent in the second quarter), according to WIFO's latest flash estimate. The year-on-year growth rate was 1.5 percent. The decline was exceptionally high in the manufacturing sector (-0.7 percent quarter-on-quarter), which reacts very quickly to cyclical changes due to its export orientation. A decline of this magnitude had been last observed in 2001, when the overall economy expanded at a year-on-year rate of just 0.5 percent. While value added growth in the construction sector also slackened, the components trade, hotels and restaurants, and transport stabilised the weakening economy.

The global downturn and associated uncertainty led to a decline both in exports of goods and services (-0.3 percent) and in the demand for equipment investment (-0.2 percent). Household expenditure, on the other hand, remained stable (+0.3 percent quarter-on-quarter).

The construction industry, in the first half of 2008 still a solid pillar in the slackening economic cycle, posted only a marginal quarter-on-quarter increase in value added (+0.2 percent) in the third quarter. Compared with the same period a year earlier, value added was down 0.7 percent. While residential construction grew moderately, civil engineering activity expanded more dynamically. Notably road and tunnel construction benefited from increased public sector demand: Civil engineering projects account for around three fourths of the public sector's total construction investment.

In the latest WIFO business survey, construction companies describe their current order books as modest, but for the most part expect a deterioration in the coming months. Against this background, the proportion of companies intending to reduce staff is up by around one fourth from the last two years.

The deterioration in industrial activity across all sectors is shown particularly clearly in WIFO's most recent business survey. In the third quarter, companies reporting a cut-back in production for the first time in five years outnumbered those reporting an expansion. Capacity utilisation in manufacturing sank to below 82 percent in October, a decline by 4 percentage points from the peak of this cycle in the spring of

Downswing spreading also to Austria

The sharp deceleration in export and industrial activity dampened GDP growth in Austria in the third quarter. Economic output barely expanded compared with the preceding quarter.

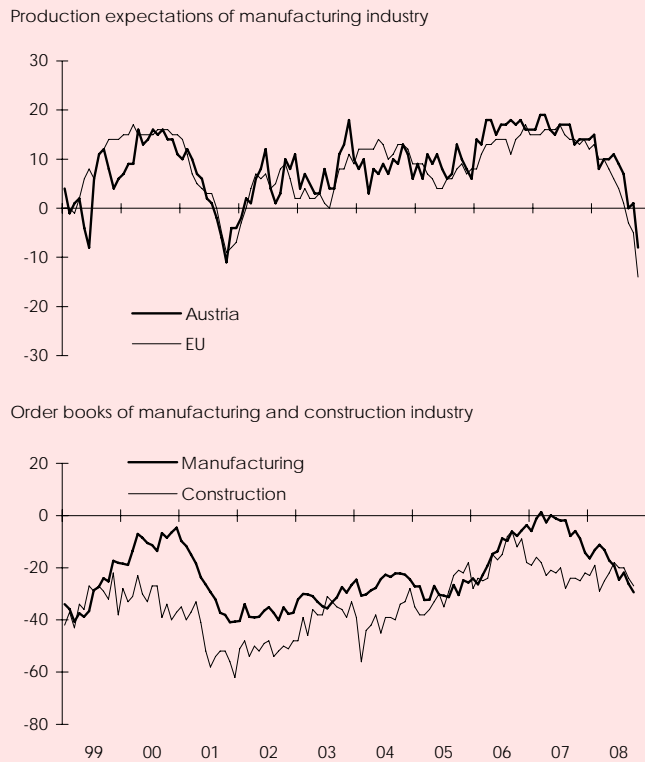
Construction activity gradually flattening

Pessimism among industrial and services-sector companies

2007. It fell especially in the production of durable consumer goods and in the motor vehicle industry.

Figure 2: WIFO business cycle survey

Differences between the percentage shares of correspondents giving positive and negative replies, seasonally adjusted



Source: European Commission, WIFO business cycle survey.

In the current downturn companies cite weak demand as the main factor impeding production, while only 1 percent name financing problems as a barrier. Fears of a noticeable shortage of corporate credit in the wake of the financial crisis appear not to have materialised up to now.

The downturn in the industrial sector is likely to intensify further in the fourth quarter, according to evidence from WIFO's business survey. One third of the surveyed companies report their order books to be insufficient; this compares with only one fifth of the companies in the spring of 2007. Due to weakening demand from Austria's major trading partners, companies' assessment of foreign order books has also been unfavourable since the beginning of this year and deteriorated further in October.

The pessimism among companies is reflected even more drastically in the assessment of their future business situation: While only 10 percent of the companies expect their business situation to improve in the coming six months, 37 percent anticipate a deterioration.

Firms in the business services sector have also assessed their current and future business situation more negatively lately: for the first time since 2001 more companies expect demand to fall than to rise.

From January to August, Austria's cumulative nominal exports rose by 5.4 percent year-on-year, while imports increased by 6.4 percent, according to the Foreign Trade Statistics. Export growth is being dampened in particular by the drop in demand in Germany and Italy – exports to these countries account for almost 40 percent of Austrian exports. From January to August 2008, 17 percent of Austrian exports

With production already falling, Austrian manufacturers anticipate a further deterioration in their business situation.

Global downturn weighing on exports

went to the 12 new EU countries, and 3.6 percent went to Hungary, whose economy has been hit considerably by the financial crisis.

Export demand has been weakening already since the beginning of this year, with the downward momentum intensifying in the third quarter. Real goods exports declined by 0.7 percent quarter-on-quarter in the third quarter, according to the national accounts, whereas on a year-on-year basis they still expanded by 0.5 percent. Real goods imports also declined by 0.3 percent from the previous quarter as equipment investment fell.

The sharp drop in consumer confidence is reflected in moderate retail sales gains. In September, retail sales rose by 0.9 percent in real terms year-on-year, according to preliminary estimates by Statistics Austria, not least because of one additional selling day. Adjusted for the number of selling days, however, real retail sales declined from a year earlier. Compared with the preceding month of August, the seasonally adjusted sales volume stagnated.

The loss of consumer confidence had an effect notably on sales of durable consumer goods. In August, the motor vehicle trade registered a sharp drop in sales (–8.1 percent in nominal terms, July +1.1 percent). New passenger car registrations fell by 5.2 percent year-on-year in the third quarter.

Much the same as in the 2007-08 winter season, Austria's tourism sector registered strong growth in the first five months of the 2008 summer season: from May to September 2008, real tourism sales rose by 2.4 percent, according to preliminary estimates (following +1.8 percent over the same period a year before). Austria's tourism has thus embarked on a development path that promises the recovery of market shares.

From May to September, the number of overnight stays rose by 2.4 percent, with the demand from resident visitors growing at a somewhat faster pace (+2.7 percent) than that from foreign travellers (+2.3 percent). The overall result was largely driven by the strong demand registered in May (+16.4 percent) as well as in July (+3.5 percent). In June, the number of overnight stays declined (–3.3 percent) – in part due to calendar variation – whereas in August it somewhat exceeded the year-earlier level (+0.8 percent). September saw a marginal fall in demand (–0.4 percent), apart from the cool and wet weather most likely already due in part to the sharp deceleration in global economic activity.

A vigorous increase was recorded in the number of overnight stays by guest from Russia (+88.4 percent) and Austria's eastern neighbouring countries (Poland +34.2 percent, Czech Republic +22.4 percent, Hungary +8.3 percent), whereas a decline was registered in the demand from Italy (–1.0 percent), Belgium (–2.5 percent), Switzerland (–3.0 percent), Great Britain (–5.3 percent) and the USA (–17.4 percent).

Collectively agreed wages for employed persons were up by 3.1 percent year-on-year in September – a rate similar to those seen in the previous months of this year. Given an average annual inflation rate of 3.5 percent in the first three quarters, this means a fall in real gross per-capita earnings.

The current autumn pay round is guided by the slowdown in economic activity and compensation for the unexpected acceleration of inflation in 2008. In November, the parties negotiating a pay deal for the metal industry agreed on a pay rise of 3.8 percent for actual wages (+3.9 percent for minimum wages). In addition, a one-off payment of € 100 to € 250 to be linked to the operating result (EBIT) was agreed.

In 2007, actual wages had also been raised by 3.5 percent plus a one-off payment (€ 200 at the most) that was also profit-linked. Wage developments in other sectors usually follow the wage settlement for the metal industry.

Austria's goods and services exports have clearly lost momentum in the course of this year. Exports already declined quarter-on-quarter in the third quarter.

Trade hit by weak demand

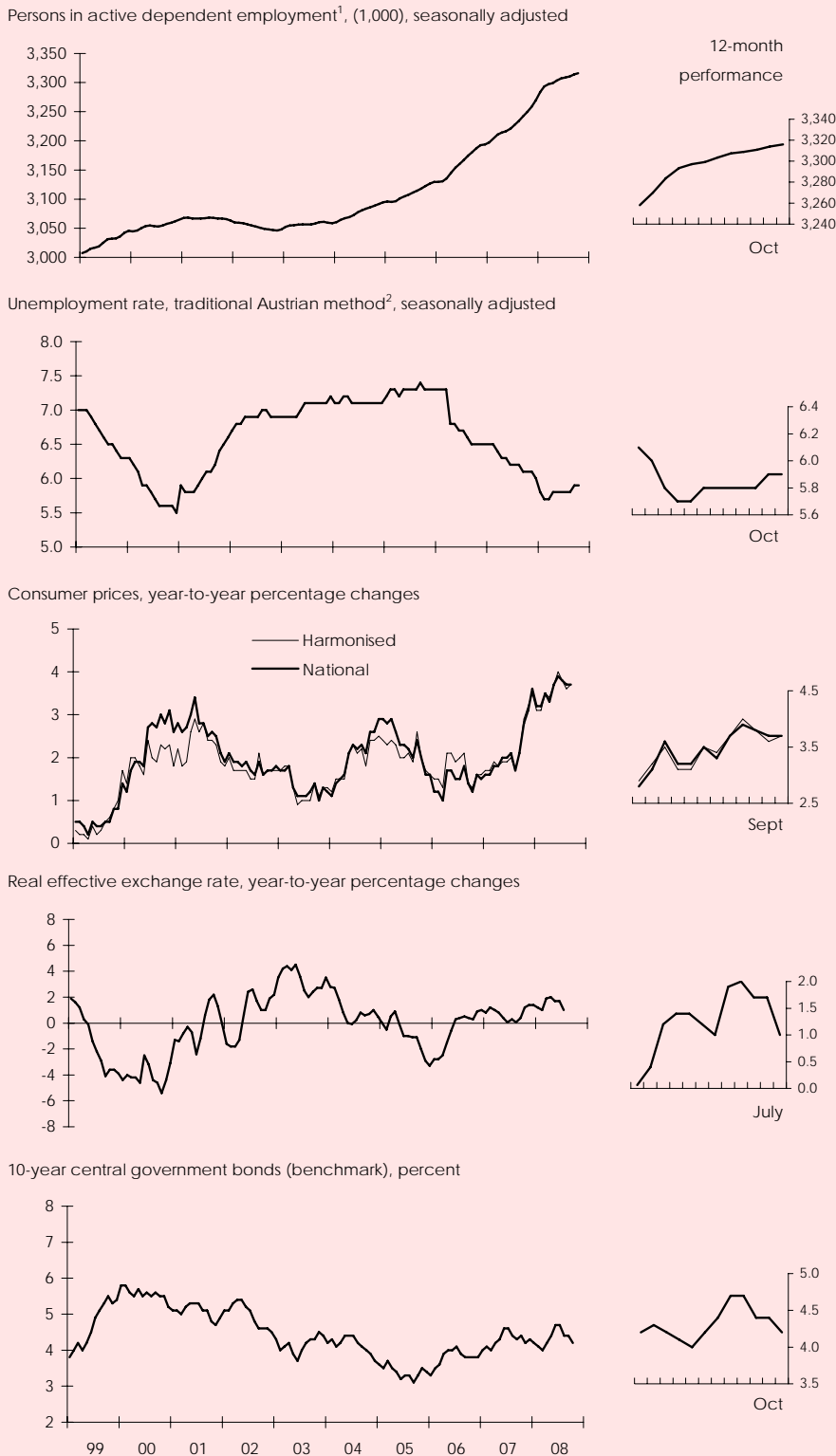
The global downturn and the financial crisis are weighing on consumer sentiment and are depressing sales in retailing and the motor vehicle trade.

Summer tourism: strong sales increase

Wage settlements for metal industry: almost 4 percent

Against the background of the economic downturn and accelerated inflation, the parties negotiating a pay deal for the metal industry agreed on a pay rise of 3.8 percent for 2009.

Figure 3: Key economic indicators



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.

The inflation rate (CPI) remained unchanged in September from the month before (3.7 percent, July 3.8 percent, June 3.9 percent). With crude oil prices falling steadily since the summer – and prices for fuel and heating oil declining as a result – the influence of the expenditure category "Transport" shrank but, accounting for more than one fourth of overall inflation lately, still remained high. In September, fuel

Inflation remains high

prices rose by 18 percent on average, contributing 0.7 percentage points in all to the inflation rate, compared with still 1.2 percentage points in June, when prices had risen by 32 percent on average.

In the food sector, signs of decelerating inflation are beginning to emerge, reflecting currently falling agricultural prices. However, at 6.7 percent on average, price increases still remained high in September and contributed 0.8 percentage point to headline inflation. Based on euro prices, the HWWI Index of World Market Prices of Commodities, which comprises food, drinks and tobacco as well as energy and industrial raw materials, has been falling on a month-on-month basis already since August.

HICP (Harmonised Index of Consumer Prices) inflation also stood at 3.7 percent in September and was thus marginally higher than the euro area average (3.6 percent).

Although employment is still growing noticeably, the labour market already shows first signs of weakening in reaction to current economic developments. In October, the number of persons in dependent active employment rose by 1.9 percent (+61,600) from a year before, a decline from an average growth rate of 2.9 percent in the first half of 2008. The seasonally adjusted month-on-month rate of increase also fell in the course of this year.

At the same time, unemployment is declining at a slower pace. In October, the number of registered unemployed totalled 202,800, a drop by 2,100 (-1.0 percent) from a year before; this compares with an average decline by 21,000 (-8.9 percent) in the first half of the year. The month-on-month comparison based on seasonally adjusted figures, which reflects a trend reversal more quickly than the year-on-year comparison, has shown unemployment on the rise already since April.

The seasonally adjusted unemployment rate according to the Austrian method of calculation remained steady at 5.9 percent in October. The unemployment rate seasonally adjusted according to a new method by Eurostat stood at 3.2 percent in September (3.3 percent in August).

The number of job vacancies fell yet again (-2,900, -7.6 percent year-on-year), also an indication that the turning point in the labour market may now have been reached.

The inflation rate remained steady at 3.7 percent in September. Price increases for food and energy accounted for almost half of overall inflation, but their influence has been decreasing since the summer.

Signs of labour market weakening

The deteriorating economy is now also beginning to affect the labour market. Employment continues to grow in year-on-year terms, albeit at a markedly slower pace than last summer.