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Second Half of 2014 Marked by Stagnation of Austrian Economy

Business Cycle Report of February 2015

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Global economic developments have been uneven, but activity has recently been robust notably in large economies such as the USA and the UK. In the euro area, by contrast, momentum has been muted. The Austrian economy stagnated in the second half of 2014. Given the somewhat more positive economic situation in the spring as well as a growth overhang from 2013, total GDP growth in 2014 was 0.3 percent. Leading indicators continue to paint a bleak picture. Against this background, the first quarter of 2015 is also expected to be marked by lacklustre economic activity, despite the currently favourable development of crude oil prices and the weaker euro.

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Weak domestic demand, a decline in exports and in value added in manufacturing, trade and construction marked economic developments in Austria in the fourth quarter of 2014. Hence the sluggish trend witnessed in the preceding quarters continued at the end of the year. Compared with a year before, aggregate production fell by 0.1 percent in the fourth quarter. Economic growth for 2014 as a whole was 0.3 percent.

Leading economic indicators suggest that the lacklustre trend will persist in the coming months. There is still barely any evidence of a pick-up in momentum. The global economy, meanwhile, is faring better. Global economic developments have been uneven, but activity has recently been robust notably in large economies such as the USA and the UK. In the euro area, by contrast, momentum has been rather subdued, albeit better than in spring 2014.

Consistent with the European trend, inflationary pressures diminished further also in Austria. CPI inflation stood at 1.0 percent in December 2014. The inflation rate for the year 2014 as a whole averaged 1.7 percent, a decline from previous years. Apartment rents, which rose by 4.0 percent, exerted strong influence on annual inflation. The increase in administered prices (totalling +2.9 percent in 2014) also clearly exceeded the general rate of inflation for 2014. In 2014, inflation as measured by the HICP in Austria was noticeably higher than the euro area average (around +1 percentage point), despite the weaker economic momentum.

The economic weakness so far has not stood in the way of persistent labour supply growth in Austria. The number of persons in dependent active employment rose continuously in 2014, and in January 2015 exceeded the year-earlier level by just under 26,000 (based on preliminary data). As a survey conducted by Statistics Austria shows, 62,400 vacant jobs, or 4 percent fewer than a year before (2013: 65,000), were available on average in 2014. 54 percent of the vacancies ascertained in the survey were also registered with the Public Employment Service Austria (AMS). In January, 406,200 persons were registered as unemployed with the Public Employment Service Austria. Hence the seasonally adjusted unemployment rate was 8.6 percent.

1. Global economy trending upward in second half of 2014

The expansion of the global economy accelerated over the course of 2014. Following only very modest expansion in the first six months of the year, gross domestic product increased more briskly recently. Global trade, which had posted only very weak growth in the first half of the year, also picked up.

Economic momentum in advanced economies remains highly diverse. A clear upward trend is apparent in the USA: GDP rose by 0.7 percent in the fourth quarter of 2014 compared with the previous quarter, and the unemployment rate fell amid solid employment growth. Even so, there remained significant under-utilisation of labour resources overall. The unemployment rate was still markedly higher than in 2007, before the outbreak of the financial and economic crisis. Besides, the labour force participation rate fell more strongly than was to be expected based on demographic trends.

The UK has seen just as vigorous an increase in output for more than a year now. Accordingly, labour market conditions have improved considerably meanwhile. In the euro area, by contrast, output once again rose only modestly overall in summer 2014, after the recovery that had been set in motion had come to a halt in the spring. Developments were rather diverse, however: for instance, notably the Spanish economy posted very vigorous growth recently (fourth quarter of 2014 +0.7 percent, quarter on quarter, 2014 as a whole +1.4 percent). By contrast, German GDP expanded by only 0.3 percent implicitly in the fourth quarter, and by 1.5 percent over the whole of 2014.

Japan's economy once again slipped into recession, with GDP shrinking also in the third quarter, following the sharp contraction in the wake of the value added tax increase in spring 2014. This was largely due to a sharp decline in inventories, however, and output is likely to have increased again towards the end of the year.

Emerging market economies have again seen a somewhat faster expansion recently, but the basic trend remains muted. Following the pronounced weakness in the first half of 2014, the majority of the large emerging market economies saw a slight pick-up in output in the third quarter. In China, the robust trend, which had begun already in the spring, continued. However, the latest leading indicators point to a slowing momentum in the following months – the purchasing managers' index recently fell below the threshold indicating expansion. India saw a more rapid acceleration in activity in 2014. Here, too, the medium-term growth path apparently flattened, with growth below levels recorded in the mid-2000s. While economic activity has bottomed out in Latin America – in Brazil output increased again in the third quarter of 2014 after shrinking in the first and second quarters – one cannot speak of an upswing. In Russia, the decline in aggregate production that had been expected by many did not materialise, thanks to a record grain harvest. The ramifications of the Ukraine political crisis nevertheless dampened the investment climate and consumer confidence. These influences are likely to persist, given that recently the EU, after a respective policy decision, significantly extended its set of sanctions in relation to the Ukraine conflict.

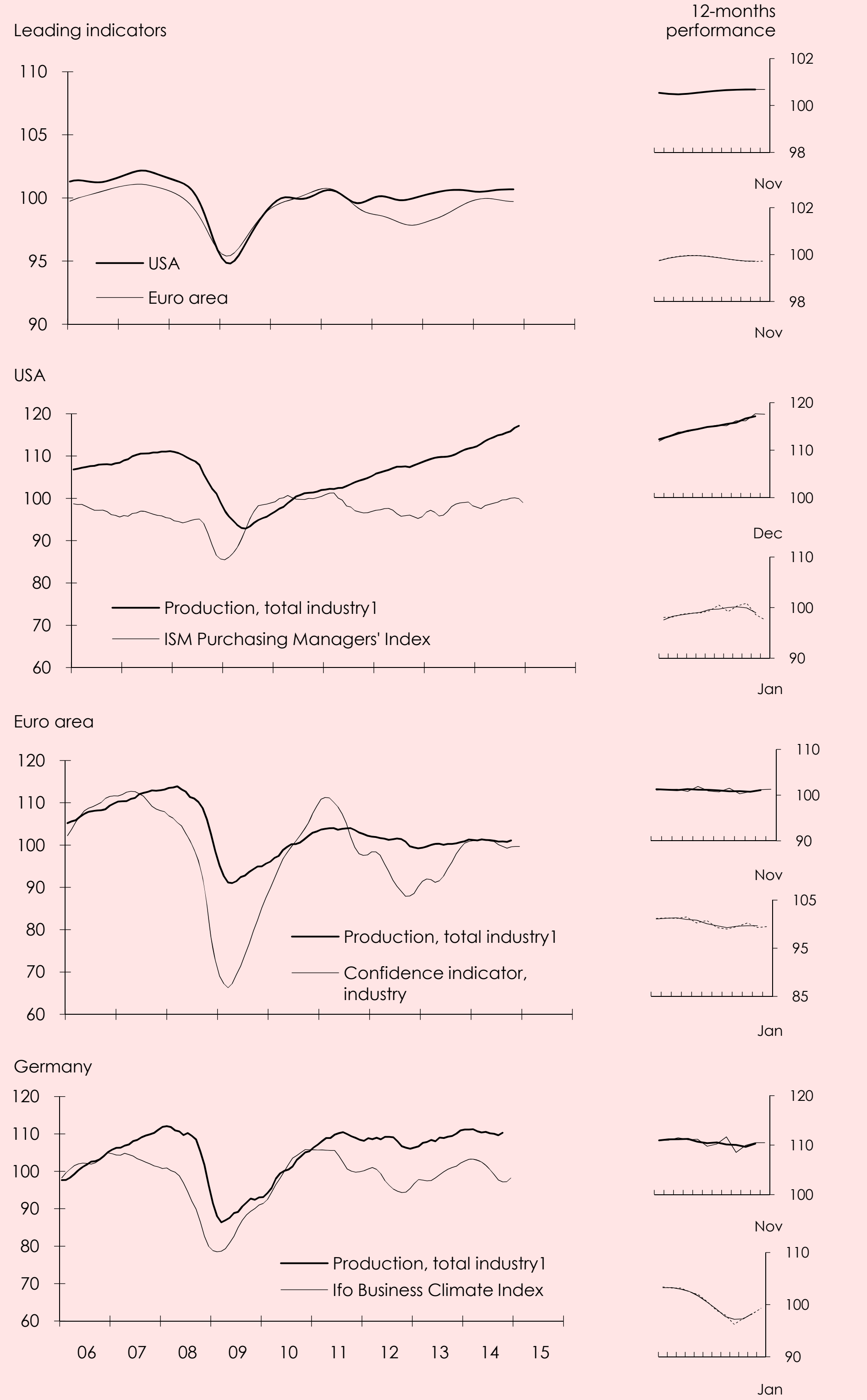
1.1 General environment for global economy has improved

In the last five months, the crude oil price fell by roughly half from $ 100 to around $ 50 a barrel of Brent crude. Unlike the short-term and much less pronounced price declines in spring 2012 and in summer 2013, this massive plunge in prices was not largely driven by lower demand expectations – for instance as a result of beginning pessimism regarding the economic outlook – but by a structural oversupply in oil markets due to an expansion of production outside OPEC, notably in the USA. The fact that the prices of other commodities have not fallen in recent months, and some have even shown a slightly rising trend, also speaks for a supply-side cause.

The plunge in prices was triggered by Saudi Arabia's decision not to cut production in this situation but to put up with lower prices so as to reduce the incentive for the frequently very expensive development of new oil fields and to protect its market share in the long term.

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.

1.2 Monetary policy providing new expansionary impetus

Monetary policies, while diverging across advanced economies, remain highly expansionary everywhere.

Consistent with increasingly diverse economic conditions, central banks in the individual countries in recent months have taken measures moving in opposite directions. While in the USA the programme for the purchase of additional bonds was terminated in the autumn, the ECB and the Bank of Japan decided to adopt an even more expansionary policy. The divergent paths of monetary policies were reflected in – in some cases substantial – exchange rate changes: the euro and notably the yen lost considerable value, while the exchange rates of the dollar and the British pound rose noticeably.

The Governing Council of the ECB on 22 January 2015 decided to launch an expanded asset purchase programme ("Quantitative Easing") with a volume of more than € 1,000 billion. The programme provides for the purchase of government bonds by the ECB and the national central banks. Purchases by the latter will be coordinated by the ECB, and are limited to 33 percent of a euro country's outstanding debt. The programme is intended to spur bank lending and investment activity, can be expanded further, and has no time limit.

Yields on government bonds have already hit all-time lows in the euro area, however, and banks have access to central bank money almost at no charge and up to an unlimited amount. Therefore bank lending rates and lending to risky debtors have already for quite some time not been influenced by restrictions and central bank refinancing costs. In general, the expansionary monetary policy stimulus will have a rather small impact on the real economy, given that the liquidity expansion by the ECB is geared less to company financing, but is mainly intended to prevent the risk of a progressing deflationary development in the euro area. The decline in inflation primarily reflects the sharp fall in oil prices. This, on the other hand, is a result of the mentioned expansion of production, which cannot be influenced by the ECB.

The Swiss National Bank recently abolished the minimum exchange rate for the Swiss franc against the euro.

On 15 January 2015, the Swiss National Bank discontinued the minimum euro exchange rate target of 1.20 Swiss francs per euro it had introduced more than three years ago – a monetary policy decision with the potential of far-reaching consequences for Austria that will lead to a deterioration in the financial situation especially of borrowers holding loans denominated in Swiss francs. Among all EU countries, the volume of loans issued in Swiss francs is highest in Austria at € 35,600 million (spring 2014), followed by Poland and France. On the other hand, the discontinuation of the Swiss franc/euro exchange rate linkage could give additional positive impetus to Austrian exports to Switzerland.

2. Austria: 2014 marked by persistent economic weakness

Weak domestic demand and the decline in export demand determine economic developments in Austria.

The Austrian economy remains mired in a phase of weakness. According to WIFO's most recent Flash Estimate, Austrian GDP stagnated also in the fourth quarter of 2014 (first and second quarter +0.1 percent each, third quarter of 2014 0.0 percent). Compared with a year before, aggregate production declined by 0.1 percent in the fourth quarter. Economic growth for the year 2014 as a whole was 0.3 percent.

The persistent investment restraint by companies, weak private consumption and an overall subdued foreign trade momentum marked economic developments in Austria also in the fourth quarter. Imports decreased, owing to the high import share of Austrian exports and the lack of domestic final demand. Gross fixed capital formation, after showing a trend towards recovery in the fourth quarter of 2013 and in the first quarter of 2014, declined in the latter half of 2014. Firms do not expect an increase in demand that would require an expansion of capacity. Fixed investment therefore primarily serves replacement and modernisation purposes. Private consumption grew at a quarter-on-quarter rate of only 0.1 percent in real terms in the fourth quarter of 2014, while government consumption increased by 0.2 percent.

The slowdown originated in the production sector, largely as a consequence of the decline in exports. Overall, new export orders as well as industrial new orders have been broadly flat or even declining since the beginning of 2014. Business sentiment has been deteriorating continuously since March, and production has been cut somewhat since the third quarter. Goods production declined by 0.2 percent in real terms in the fourth quarter, according to WIFO's most recent Flash Estimate. Construction production also continued to fare badly (fourth quarter –0.6 percent in real terms, compared with the previous quarter). Economic activity was supported by value added in the market-oriented hotel and restaurant (+0.4 percent), housing (+0.5 percent) and other financial services (+0.9 percent) sectors. Value added in the trade, motor vehicle, construction, transport as well as information and communication sectors exerted a dampening effect.

2.1 Picture painted by indicators remains bleak

The picture painted by leading indicators suggests that the momentum for economic activity will be muted in the first quarter of 2015.

The results of the January 2015 WIFO Business Cycle Survey again show deterioration, after a modest recovery in December. Assessments of the current situation have somewhat worsened, and companies' expectations for the coming months are clearly more sceptical than in the previous month. Austrian companies continue to expect a rather cool economic climate.

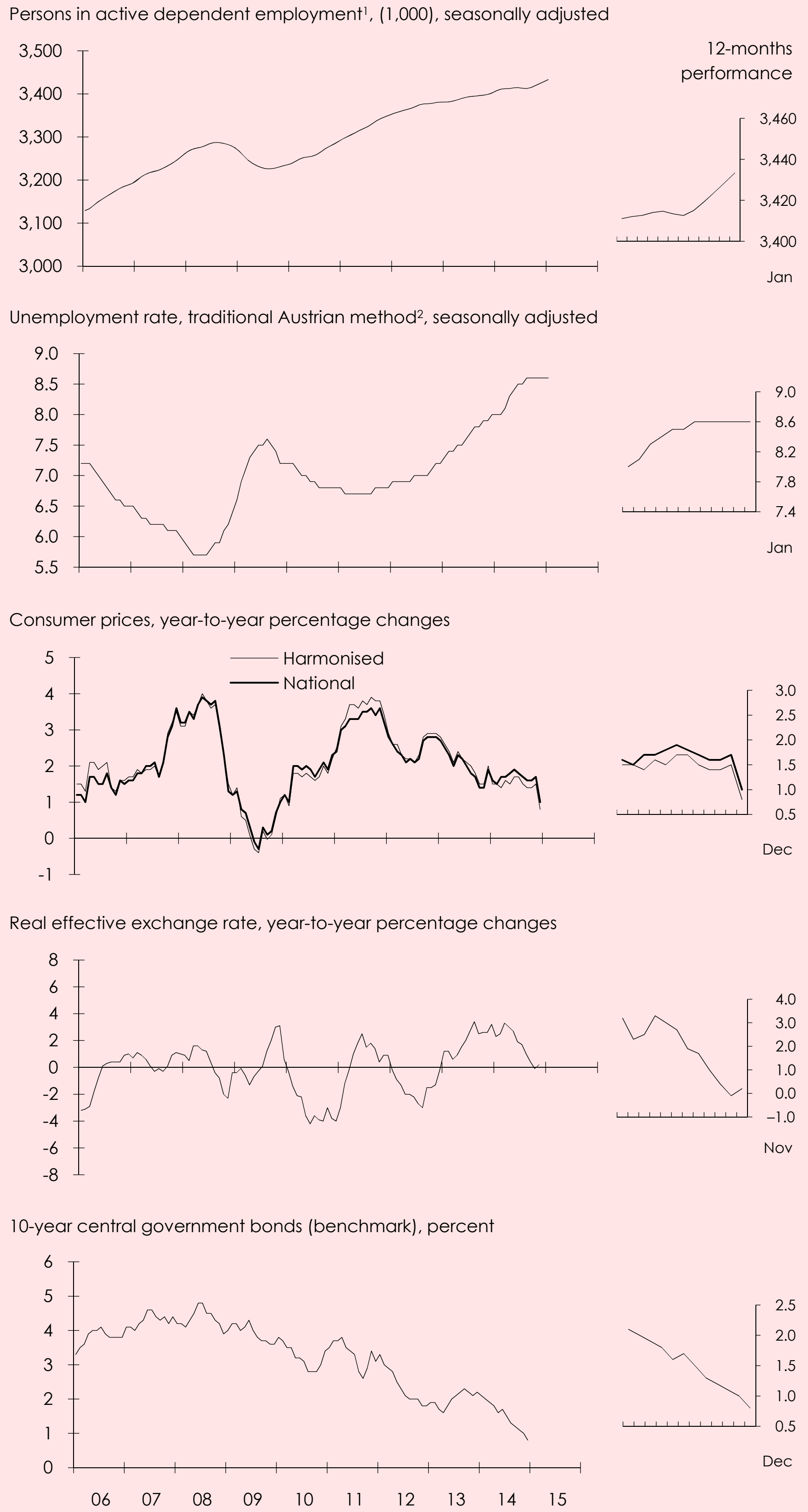
Figure 2: Results from the WIFO Business Cycle Survey

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 current situation index for the economy as a whole remains in negative territory, i.e., negative assessments by companies outweigh positive appraisals. This decline largely reflects developments in the services sector. The index deteriorated also in manufacturing, while it rose marginally in construction. The business expectations index fell noticeably in January compared with the previous month. The sharpest decline was registered in the construction sector.

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.

After moving continuously downward recently, WIFO's Leading Indicator did not decline further in January. It is therefore likely that the decline has started to bottom out and a reversal of the economic trend to be expected from the second quarter onwards has been initiated. Meanwhile, the Bank Austria Purchasing Managers' Index deteriorated again in January. This was already the fifth consecutive month in which the index remained below the threshold indicating growth of the Austrian industry.

2.2 Inflation declined in December 2014

The inflation rate stood at 1.0 percent in December 2014. Excluding the fall in fuel and heating oil prices it would have been 1.6 percent.

The inflation rate declined to 1.0 percent in December 2014 (November +1.7 percent), the lowest rate recorded since February 2010. The decline was driven by the fall in fuel and heating oil prices, which on a year-on-year basis was much more marked than in November. Upward pressures on inflation were exerted by prices in the restaurants and hotels expenditure category (especially services related to the provision of food and drink +3.0 percent). The average inflation of 2.0 percent in the "Miscellaneous goods and services" expenditure category was driven primarily by price hikes for insurance services.

Price developments in the "Housing, water, energy" expenditure category were highly diverse in December: the sharp increase in rents (+5.1 percent overall) was partly offset by a fall in household energy prices (–2.9 percent overall; heating oil prices –19.8 percent, November 2014 –9.7 percent).

In 2014, inflation as measured by the consumer price index stood at 1.7 percent, a decline from previous years (2013 +2.0 percent, 2012 +2.4 percent, 2011 +3.3 percent). Since the year 2000, lower rates had been recorded only in 2009 (+0.5 percent), 2006 (+1.5 percent) and 2003 (+1.3 percent). Annual inflation was driven especially by price increases in the "housing, water, energy" expenditure category (rents +4.0 percent, maintenance +2.0 percent). Rent increases accelerated in the course of the year, while maintenance cost increases slowed. Household energy bills fell by 0.4 percent overall in year-on-year terms in 2014.

Administered prices[1] (+2.9 percent) in 2014 rose much more sharply than did the general price level, and more vigorously than in 2013 (+2.3 percent). This sharp rise was driven by the increase in the motor-related insurance tax in March 2014. Rates for nursing home places increased by 4.0 percent year on year in 2014, and fares for local public transport rose by 2.7 percent.

Inflation in Austria – as measured by the HICP – significantly exceeded the euro area average in December 2014, despite the weaker economic momentum.

Inflation as measured by the harmonised index of consumer prices was 0.8 percent in December 2014 (November +1.5 percent). Given its higher weight in the HICP, the substantial fall in fuel prices considerably dampened HICP inflation compared with CPI inflation. Similarly, CPI inflation rose more sharply than HICP inflation owing to the increase in the motor-related insurance tax (not taken into account in the HICP), price increases for insurance services, housing maintenance and package tours (lower weight in the HICP than in the CPI).

The price rate of change averaged –0.2 percent in the euro area recently. Hence the inflation differential for Austria was +1 percentage point, reflecting primarily developments in the food (including alcohol and tobacco; +0.3 percentage point) and services (+0.7 percentage point, with +0.3 percentage point being accounted for by hotels, cafeterias and restaurants, and 0.1 percentage point each by telecommunication, healthcare services and apartment rents) categories.

2.3 Activity in the tourism industry remains stable

According to provisional calculations, tourism revenue in the first two months of the 2014-15 winter season, at € 3,150 million (–0.1 percent) was more or less unchanged from the level recorded in the same period in 2013. Adjusted for price changes, total sales declined by 1.4 percent. In November and December 2014, the number of

[1] Prices of goods and services which in accordance with laws and/or regulations by the federal government, a federal province or a municipality are dictated entirely or in part by the state.

overnight stays rose by 1.1 percent overall to 15.13 million, the highest level since statistical records began being kept. This overall result is owed primarily to the strong growth in Vienna tourism (+7.3 percent), whereas the demand in the rest of Austria stagnated (+0.1 percent). Another decisive factor was the positive development of nights spent by international guests (+1.7 percent), which accounted for almost three fourths of the total demand. Domestic demand, meanwhile, declined slightly (–0.3 percent).

Only nights spent in commercial and private holiday apartments rose markedly in the first two months of the 2014-15 winter season (+5.7 percent and +2.7 percent, respectively); slightly above-average growth was registered in the demand for accommodation in 5&4-star establishments (+1.7 percent) and in 2/1-star establishments (+1.2 percent). While 3-star hotels recorded only a small decline (–0.3 percent), the demand for private rooms remained 8.3 percent below the year-earlier level.

The demand by international guests for the destination Austria varied greatly in November and December 2014: a sharp increase was registered in the number of nights spent by travellers from Poland, Romania, Italy, the UK and the USA. Nights spent by guests from Germany, the most important source market, declined slightly, and so did those by guests from Sweden and Hungary. The demand from Russia fell by just under one fourth.

Total tourism revenue in November and December 2014 increased in Vienna, Burgenland and Tyrol, while it only slightly exceeded the year-earlier level in Carinthia. The tourism sector in the other federal provinces registered a decline compared with a year before; this decline was weak in Lower Austria, moderate in Upper Austria, Salzburg and Styria, and very sharp in Vorarlberg.

2.4 Ambivalent developments in labour market

The supply of labour continues to expand. Employment growth is accompanied by a marked increase in unemployment.

The subdued economic activity so far has not stood in the way of a persistent expansion in the supply of labour. In 2014, the number of people in dependent active employment rose steadily, and in January 2015 exceeded the year-earlier level by just under 26,000 (preliminary data). At the same time the number of unemployed people increased by around 36,400. The seasonally adjusted unemployment rate was 8.6 percent. The strong expansion in the supply of labour continued to be driven exclusively by immigration. A survey conducted by Statistics Austria shows that 62,400 vacant jobs, or 4 percent fewer than a year before (2013: 65,000), were available on average in 2014. 54 percent of the job vacancies ascertained in the survey were also registered with the Public Employment Service Austria.

The sector profile of employment developments barely changed compared with spring 2014. Employment increased markedly in public administration, healthcare and the social services sector. The production sector, financial and insurance services and trade, by contrast, did not contribute to employment growth.