EWALD WALTERSKIRCHEN

DIVERGING TRENDS IN AUSTRIA'S ECONOMY

The turbulence on the international financial markets has markedly slowed down the growth of the global economy. Exports and manufacturing output in Austria were increasingly affected by these developments in the fall of 1998; the business climate worsened in the fourth quarter in the manufacturing sector. Despite these setbacks, domestic demand remained robust. Consumer confidence continued on its upward trend in October, thanks to rising purchasing power, improved labor market conditions, and lower inflation.

The economic upswing in Austria has been weakening as a result of unfavorable international conditions. The slowdown of the international economy triggered by the Asian crisis has been exacerbated by the financial turmoil in Russia and Latin America.

The deterioration in the global economy is manifest in the performance of Austria's merchandise exports: after posting two-digit growth rates in the first half of 1998, exports (according to the statistics compiled by the Austrian National Bank) grew by only 7 percent in the third quarter on a year-on-year basis. Exports to South-East Asia, to OPEC, and to Russia declined sharply.

The weakening of export growth has adversely affected the manufacturing sector. The growth rate of the value of output declined from 9 percent in the first half of the year to about 5 percent in the months July and August; output and profitability in the basic-goods industries was particularly hard hit by the plunge in internationally traded commodities.

The business climate in manufacturing continued to worsen in the fourth quarter. The balance of negative and positive output expectations was barely in the positive range, as weak foreign orders and adverse price expectations darkened the outlook.

The assessment of the cyclical position varies markedly from sector to sector. While prospects deteriorated significantly in the basic-goods sector, expectations remained basically stable in the investment and consumer goods sectors.

The negative impact of foreign trade on Austria's economy was alleviated by the pick-up in domestic demand, as households, after several meager years, again experienced substantial real income gains. This resulted from lower inflation (deep cuts in prices of crude oil and of raw materials), a rise in employment,

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and higher income growth. Domestic demand was also boosted by the persistent decline in interest rates. In the third quarter, retail sales (adjusted for price increases) exceeded the level of the corresponding quarter of last year by 3¼ percent.

A sustained deterioration in international economic conditions is bound to have a negative impact also on investment activity, however. The coordinated cut in base interest rates in the EU at the beginning of December was aimed at countering the danger of a deeper slump. In the 1990s, Europe's economy was shaken by a series of financial and currency crises. The recession of 1993, which was deepened by a restrictive monetary policy, was followed by the currency crisis of 1995-96, and then by the financial crisis of 1998. The challenge to stabilization policy under these circumstances consists less in deploying its traditional fiscal instruments than in preventing or containing crises on the liberalized financial and foreign exchange markets. The realization of the European Monetary Union on 1 January 1999 is an important step in this direction.

Cut-off date: December 9, 1998.