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Heading into Recession

Business Cycle Report of December 2008

The Austrian economy barely expanded quarter-on-quarter in the third quarter of 2008 (+0.1 percent), but unlike Germany's is not yet in a recession. However, sharply falling order book levels and business expectations suggest that economic activity will weaken further in the coming months. This assessment is supported by current labour market developments: unemployment rose slightly in November, the number of job vacancies dropped sharply.

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The real economy is now feeling the full impact of the global financial crisis. Starting out with exports, the economic downturn is spreading to all other demand components. The Austrian economy barely expanded quarter-on-quarter in the third quarter of 2008 (+0.1 percent). The export-oriented manufacturing industry already recorded a marked decline (–0.8 percent).

In year-on-year terms, economic growth decelerated noticeably from 2.9 percent in the first quarter to 1.2 percent in the third quarter. This development started out with exports: their year-on-year growth rate fell from +6.7 percent in the first quarter to +1.5 percent in the third quarter. This reflects the global economic downturn: a recession is already under way in the USA, Japan and Europe, but not yet in Austria.

Order books and business expectations of Austrian companies are drastically deteriorating and show no signs of stabilising yet. Meanwhile, the negative assessment of the economic situation has begun to spread from manufacturing to the services sector.

Darkened sentiment owing to the financial crisis dragged down retail sales volumes in the third quarter (–0.1 percent in real terms year-on-year). The retail sector was affected by the relatively strong price increases, and the motor vehicle trade by pessimistic consumer expectations.

Tourism businesses recorded a successful summer season, with both the number of overnight stays and real sales increasing by 2½ percent. Bookings for the winter season are also satisfactory. Experience shows, however, that international tourist travel expenditure tends to react to an exceptionally high degree to a cyclical downturn. This will be reflected in next summer season's sales figures.

International commodity and crude oil markets saw prices plummet as global demand dampened and speculation for further falls followed. At the beginning of December, the crude oil price stood at just slightly above 40 $, a third compared with the peak price of 140 $ per barrel recorded in July. Austria's inflation rate fell from 3.8 percent in September to 3.1 percent in October. A decisive factor here was to the month-on-month decline in fuel and heating oil prices; the upward pressure on food prices also eased.

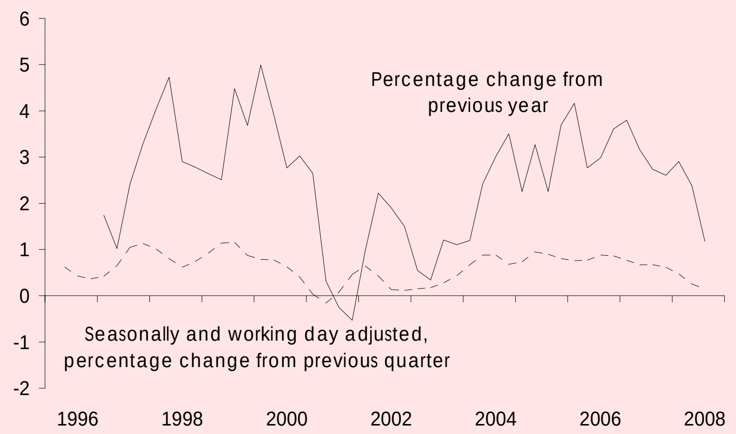
Table 1: Quarterly national accounts

	2006	2007	2007 Second quarter	2007 Third quarter	2007 Fourth quarter	2008 First quarter	2008 Second quarter	2008 Third quarter
			Percentage change from previous quarter					
Adjusted for seasonal and working day effects, volume								
Final consumption expenditure			+ 0.1	+ 0.6	+ 0.4	– 0.4	+ 0.7	– 0.1
Households[1]			– 0.1	+ 0.3	+ 0.4	+ 0.2	+ 0.2	+ 0.2
General government			– 0.1	+ 1.6	+ 0.8	– 2.3	+ 2.5	– 1.0
Cross capital formation			+ 0.6	+ 0.6	+ 0.6	+ 0.8	+ 0.6	+ 0.6
Gross fixed capital formation			+ 0.9	+ 0.9	+ 0.7	+ 0.7	+ 0.7	+ 0.5
Machinery and equipment			+ 1.3	+ 1.1	+ 0.8	+ 0.9	+ 1.1	+ 0.5
Construction			+ 0.3	+ 0.4	+ 0.5	+ 0.5	+ 0.2	+ 0.0
Exports, goods and services			+ 2.1	+ 1.7	+ 1.2	+ 0.7	+ 0.2	+ 0.3
Goods			+ 1.7	+ 1.2	+ 1.7	+ 1.0	– 0.6	+ 0.3
Services			+ 1.9	+ 1.8	+ 1.5	+ 1.1	+ 0.9	– 0.2
Imports, goods and services			+ 1.5	+ 1.8	+ 1.0	– 0.4	+ 0.7	– 0.0
Goods			+ 1.7	+ 1.7	+ 1.0	– 0.4	+ 0.9	– 0.1
Services			+ 1.2	+ 1.2	+ 0.7	+ 0.3	+ 0.2	+ 0.3
Gross domestic product			+ 0.7	+ 0.7	+ 0.6	+ 0.5	+ 0.3	+ 0.1
Manufacturing			+ 0.9	+ 1.1	+ 1.6	+ 1.4	– 0.3	– 0.8
			Percentage change from previous year					
Volume, chained prices								
Final consumption expenditure	+ 2.4	+ 1.2	+ 1.1	+ 0.8	+ 1.4	+ 0.7	+ 1.1	+ 0.9
Households[1]	+ 2.4	+ 1.0	+ 1.0	+ 0.4	+ 1.0	+ 1.0	+ 0.8	+ 1.1
General government	+ 2.3	+ 1.8	+ 1.2	+ 1.9	+ 2.6	+ 0.1	+ 1.9	+ 0.2
Cross capital formation	+ 2.4	+ 3.6	+ 2.3	+ 4.2	– 1.1	+ 0.5	+ 5.2	+ 5.6
Gross fixed capital formation	+ 2.6	+ 4.7	+ 3.1	+ 4.9	+ 3.1	+ 1.6	+ 6.0	+ 0.6
Machinery and equipment	– 0.8	+ 5.9	+ 1.0	+ 8.8	+ 7.9	– 1.7	+ 10.0	+ 0.2
Construction	+ 4.2	+ 2.8	+ 3.7	+ 1.4	– 1.2	+ 3.9	+ 2.6	+ 0.3
Exports, goods and services	+ 7.5	+ 8.8	+ 9.0	+ 8.2	+ 8.5	+ 6.7	+ 3.4	+ 1.5
Goods	+ 8.2	+ 9.1	+ 10.9	+ 7.7	+ 6.9	+ 6.6	+ 3.3	+ 1.7
Services	+ 5.3	+ 7.9	+ 3.4	+ 9.6	+ 13.1	+ 7.0	+ 4.1	+ 1.3
Imports, goods and services	+ 5.1	+ 7.5	+ 5.3	+ 8.8	+ 6.0	+ 2.9	+ 4.4	– 0.4
Goods	+ 5.2	+ 8.4	+ 5.9	+ 10.1	+ 5.8	+ 3.0	+ 4.7	– 0.7
Services	+ 4.8	+ 4.0	+ 2.8	+ 4.9	+ 6.6	+ 2.4	+ 3.0	+ 0.5
Gross domestic product	+ 3.4	+ 3.1	+ 3.2	+ 2.7	+ 2.6	+ 2.9	+ 2.4	+ 1.2
Manufacturing	+ 9.9	+ 5.5	+ 5.4	+ 4.8	+ 4.5	+ 5.2	+ 5.6	+ 2.2
Gross domestic product, value	*+ 5.3*	*+ 5.3*	*+ 5.1*	*+ 5.0*	*+ 5.1*	*+ 5.5*	*+ 5.4*	*+ 4.0*

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

Figure 1: Growth of real GDP

Percentage change from previous period



Source: WIFO.

The labour market is increasingly feeling the impact of the economic downturn. Employment gains have halved since June. A number of large enterprises registered employees for short-time work and for the moment laid off loaned employees. While employment grew by 51,300 year-on-year in November, the number of unemployed persons for the first time since 2006 exceeded the year-earlier level (+2,000). Job vacancies, which are considered a leading indicator for the labour market, were affected most by the lack of orders: the number of vacant jobs was a tenth or more lower than a year earlier.

US economic performance weakening

The US economy has been in a recession since December 2007, according to the finding by NBER. Interest rate cuts and tax rebate payments were only able to slow down the cyclical downturn.

In the USA, the crisis is increasingly spreading to the real economy. The industrial sector saw capacity utilisation fall by 3 percent to 78 percent in the course of one year. Notably the car manufacturing sector is affected: while the Big Three automakers – Chrysler, General Motors and Ford – demanded $ 34 billion in federal aid, government plans currently provide for $ 15 billion in public aid.

In the third quarter, the US economy contracted marginally (–0.1 percent in real terms) compared with the good result achieved in the preceding quarter, which had benefited from the payment of tax rebate cheques. The demand for durable consumer goods declined markedly. Car sales dropped by one third year-on-year in November, with foreign manufacturers also strongly affected (e.g., Toyota). The downward trend in residential investment continued. This suggests a further sharp decline in GDP in the fourth quarter.

Labour market conditions deteriorated considerably yet again in November. The unemployment rate rose to 6.7 percent, its highest level in 15 years. These figures are considered further evidence of a recession in the USA.

Recession in the euro area

The euro area is also increasingly feeling the effects of the global financial crisis. Economic performance is slowing, and unemployment is rising.

The euro area also finds itself in a recession at the turn of the year. The economy contracted by 0.2 percent both in the second and the third quarters of 2008 – that of Germany by 0.5 percent. According to the Euroframe Indicator, which is calculated on the basis of leading indicators, a further sharp decline may be expected in the fourth quarter of 2008 and the first quarter of 2009. Almost all leading indicators (notably business and consumer surveys) are pointing steeply downward. Therefore, real euro area GDP is likely to be 1 to 1½ percent below the year-earlier level at the beginning of 2009.

The economic downturn has been particularly sharp in those European countries whose economies over the past decade benefited from soaring real estate prices and are now suffering from their decline: they include Great Britain, Ireland, Spain, Denmark and the Baltic countries. Apart from these countries, the recession is particularly severe in Italy, whose industry has suffered major competitiveness losses over the last decade. In Germany, where there is no real estate crisis, it is the automotive industry that is increasingly finding itself in difficulties. Opel is affected by the crisis of General Motors, and BMW reported in November that worldwide sales had dropped by one fourth compared with a year earlier.

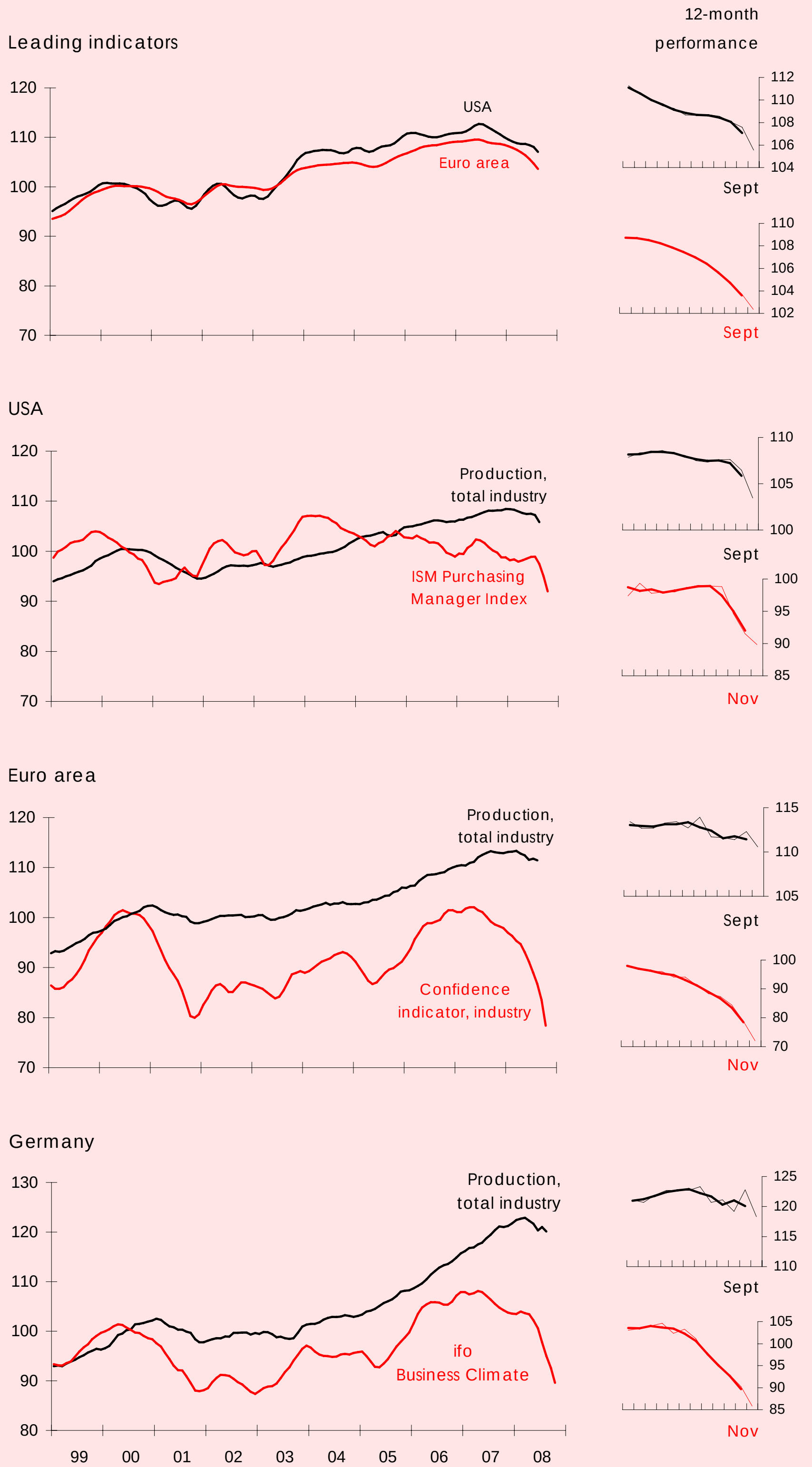
Latest survey results published by the European Commission point to a further weakening of industrial activity. In the fourth quarter, capacity utilisation in the manufacturing sector (81½ percent) dropped below its long-run average. Confidence indicators fell sharply not only in the industry and construction sectors but also in the services sector.

Retail sales volumes have been on a downward trend since the beginning of the year. Soaring inflation has eroded consumers' purchasing power and notably also their readiness to buy expensive foodstuffs. The trade in non-vital goods, above all cars and long-distance journeys, has been affected even more strongly by the cyclical downturn.

Falling crude oil prices and the euro depreciation against the dollar provide relief in this critical situation. The crude oil price has dropped to one third of the peak price of $ 140 per barrel recorded in July. At the beginning of December it was just over $ 40. The euro exchange rate has fallen by about one fifth from its peak of $ 1.58 in July 2008, thus strengthening the competitiveness of euro area businesses.

Figure 2: 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 economic downturn is likely to be more severe than the recessions experienced in previous decades. Most European countries intend to take measures to stabilise the banking sector and to implement extensive economic programmes. If measures to fight recession in Europe are to be successful no big country must pursue a "beggar-my-neighbour" strategy. Great Britain, Spain and France have provided for farreaching packages of measures, whereas Germany, the biggest country in the euro area, has been proceeding extremely hesitantly.

The European Central Bank, having raised the refinancing rate as late as July, lowered it yet again in December in reaction to the economic downturn, by 0.75 percentage points to 2.5 percent (following cuts by 0.5 percent both in October and November). Loans became more expensive in the third quarter. In Austria, the interest rate for consumer credits rose by 0.3 percentage points, and was thus 0.7 percentage points higher than a year before, but still lower than the euro area average. The interest rate for new home construction loans in Austria rose to 5.5 percent in September and thus remained marginally below the euro area average, while that for loans in Swiss Francs remained unchanged at 3.8 percent. The granting of new foreign currency loans was prohibited in autumn because of the high risk involved.

Austria's GDP up 1.2 percent in third quarter

In the third quarter, the Austrian economy expanded by 0.1 percent quarter-on-quarter. Hence economic activity has flattened continuously since the first quarter of 2007. The year-on-year growth rate in the third quarter was 1.2 percent, somewhat lower than anticipated in the flash estimate.

The Austrian economy 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). The slowdown is particularly apparent in the cyclically sensitive manufacturing sector: value added fell by 0.8 percent quarter-on-quarter. A seasonally and working day adjusted decline in value added was recorded also in the credit and insurance, trade, hotel and restaurant sectors.

Compared with the same period a year earlier, the Austrian economy advanced by 1.2 percent in the third quarter, implying a slight downward revision from WIFO's November flash estimate (+1.5 percent). Private consumption expanded by around 1 percent, much the same as in the preceding quarters. Exports, which grew by just 1½ percent in real terms year-on-year, are increasingly losing their function as a pillar of the economy. Equipment investment stagnated: the decline in machinery and equipment purchases was offset by a year-on-year increase in vehicle investment. Construction investment overall did not expand further either. While spending on civil engineering projects rose, residential investment declined.

Pessimism growing in industrial sector

Manufacturers' assessment of current order books and notably production and business expectations for the coming months are deteriorating.

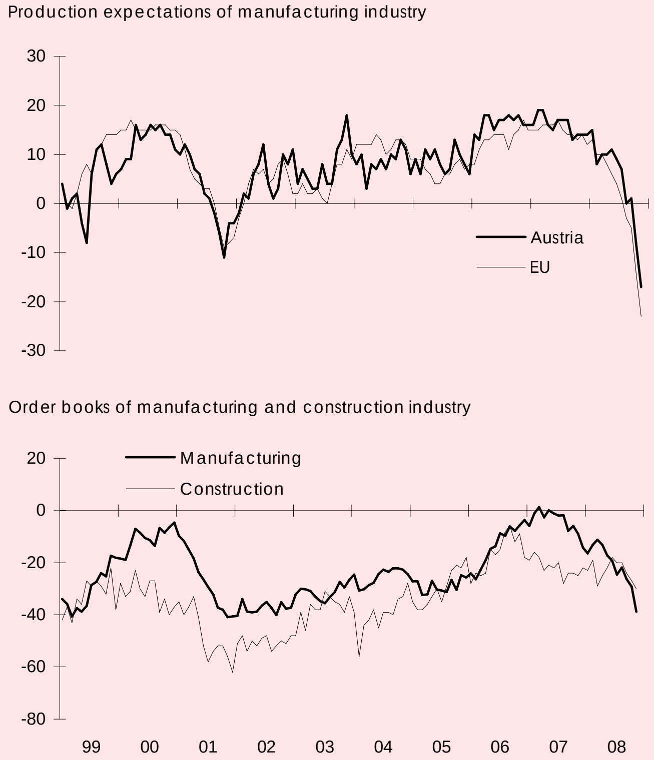
The assessment of the economic situation by Austrian manufacturers continues to deteriorate at a fast pace. Between October and November the proportion of companies having had to scale back production rose by 9 percentage points and currently stands at 26 percent. A mere 16 percent of the companies reported a production increase. Order books have also been deteriorating somewhat: only 61 percent of the companies described their order books as at least sufficient, a decline by 21 percentage points from the level recorded at the time of the cyclical peak 18 months ago.

The further downward trend becomes apparent in the assessment of the outlook for the coming months. While almost one third of the companies expect they will have to cut back production shortly, only half as many anticipate production increases. The proportion of companies expecting their business situation to worsen exceeds 40 percent and is thus eight times as high as that of firms anticipating an improvement. Expectations have not been that pessimistic since the mid-1990s.

The situation in the construction sector is also darkening further. Construction activity has developed less favourably this autumn than in recent years. Only 62 percent of the construction companies surveyed describe their order books as at least sufficient, compared with 73 percent a year ago. The proportion of companies expecting building prices to rise has halved in the past three months to around one fifth. The assessment of the employment outlook for the coming months gives little reason for hope. An exceptionally high number of companies feel compelled to reduce staff.

Figure 3: 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.

Export dynamics slowing substantially

Austrian goods and services exports have clearly lost speed in the course of 2008 in the wake of the global economic downturn.

Goods exports, which according to the national accounts in the first quarter exceeded the year-earlier level by 6½ percent in real terms, expanded by just 1½ percent year-on-year in the third quarter. Notably the dampened demand in Germany and Italy – they account for two fifths of Austrian exports – slowed down export growth. Exports to the USA, Great Britain and Spain declined noticeably.

Real goods imports according to the national accounts no longer reached the year earlier level in the third quarter, a consequence of the weak demand for capital goods and passenger cars.

Nominal imports in the first three quarters of 2008, at +6.1 percent according to the foreign trade statistics rose at a faster pace than exports (+5.6 percent). The balance of trade in goods recorded a small deficit of € 66 million (following a surplus of € 303 million in the same period in 2007). Crucial for the turn-around of the balance were high import prices for commodities and energy.

Weak retail sales performance

Darkened consumer sentiment owing to the financial crisis is dragging down retail and motor vehicle sales.

The sharp drop in consumer confidence is reflected in a weak retail sales performance. Sales (excluding the motor vehicle trade) were flat in the third quarter compared with the same period a year earlier. The sale of non-durable consumer goods was dragged down by the sharp increase in food prices (+6 percent year-on-year).

Passenger car sales have been particularly affected by the confidence crisis – in Austria much less so, though, than in the USA and Spain. New car registrations in Austria fell by 5 percent year-on-year in the third quarter, but rebounded in October (+4 percent). From January to October 2008, 258,100 passenger cars were newly licensed, an increase by 0.6 percent from the year before. Daily or weekly licences are playing an ever-greater role: 5½ percent of the new cars were licensed for up to 7 days.

Successful summer season for tourism sector

Summer tourism, boosted in early summer by still favourable global economic activity, developed more positively than last year.

Austria's tourism industry expanded relatively vigorously in the 2008 summer season – much the same as in the preceding winter season: according to preliminary estimates, total sales from May to October 2008 amounted to € 10.55 billion, an increase by 6.1 percent. In real terms, sales rose by 2.4 percent (2007 summer season: +1.3 percent).

The number of overnight stays increased by 2.4 percent, with the demand from resident and foreign guests rising at an equal pace. There were quite sizeable differences across the international markets of origin, however: very brisk growth was recorded notably in the number of nights spent by guests from Russia (+79.5 percent) and the eastern neighbouring countries. Overnight stays by guests from the two most important markets of origin rose at a weaker pace than overall foreign demand: Germany (+1.6 percent), and the Netherlands (+1.2 percent). The number of overnight stays by guests from France was somewhat higher than a year earlier. All other important markets registered a slight to moderate decline in demand (Italy, Belgium, Switzerland). A strong decline notably in October was registered in the number of nights spent by travellers from Great Britain and the USA – in both countries the repercussions of the financial and economic crisis have already dampened the readiness to travel. The fact that stays in Austria have become more expensive for guests from the USA compared with last year, owing to exchange-rate factors, may also have had an effect.

Above-trend sales growth was recorded by the tourism sector in Burgenland, Vienna, Styria and Lower Austria. Growth was slightly below trend in Salzburg, Tyrol, Upper Austria and Carinthia. Vorarlberg was the only federal province where tourism sales stagnated, albeit compared with a high year-earlier level.

Pay round dominated by inflation compensation

Against the background of a relatively high inflation rate, the parties negotiating a pay deal for the metal industry in the autumn pay round agreed on a pay rise of 3.8 percent.

The autumn pay round was guided by compensation for the unexpected acceleration of inflation in 2008 and the economic slowdown. The parties negotiating a pay deal for the metal industry agreed on a pay rise of 3.8 percent for actual wages. Collectively agreed minimum wages were raised somewhat more strongly (+3.9 percent). Like last year, an additional one-off payment ranging between € 100 and € 250 depending on the individual company's operating result (EBIT) was agreed.

As a result of this settlement, which traditionally serves as a model for the other sectors, the collective wage index will rise more strongly in the coming months. In October it was a good 3 percent higher than a year before – much the same as so far in 2008. In combination with the tax reform and the curbing of inflation, this means a marked increase in net real wages for 2009.

Inflation slowing markedly

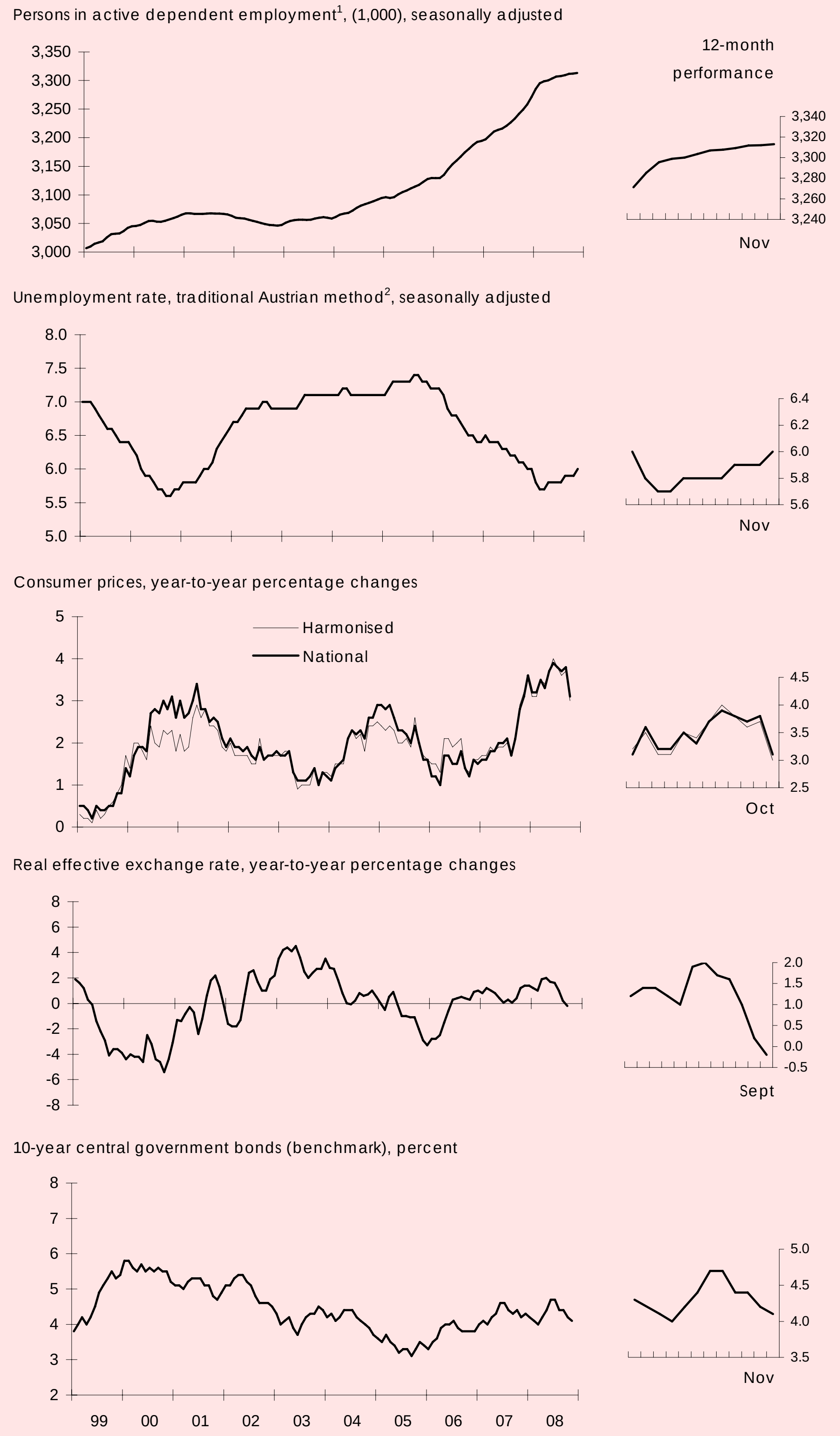
The inflation rate fell to 3.1 percent in October, largely in reaction to moderating energy prices. Inflation is set to ease further in the coming months.

International commodity and crude oil markets saw prices plummet in autumn as global demand dampened and speculation for further falls followed. In December, one barrel of crude oil (Brent) traded at slightly above $ 40 (after $ 140 in July). Industrial raw material and food prices also declined as demand weakened.

The inflation rate in Austria fell from 3.8 percent in September to 3.1 percent in October. A crucial factor here was the month-on-month decline in fuel and heating oil prices: in October, the prices in the expenditure category "Transport" exceeded the year-earlier level by 4.1 percent, after +6.8 percent in September. With the world market prices for agricultural raw materials also declining, the upward pressure on food prices eased as well. Compared with a year earlier, they were up +6.4 percent in September and +4.8 percent in October.

The Harmonised Index of Consumer Prices rose by 3.0 percent in October, at a slightly slower pace – due to different weighting – than the domestic Consumer Price Index. Inflation in Austria differed little from the euro area average.

Figure 4: 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.

Wholesale prices dropped by 1.8 percent year-on-year in November, the highest decline at the wholesale level since 1999. The fall in prices was particularly sharp for mineral oil products and grain. As consumer prices normally lag behind wholesale prices, this suggests that inflation will ease further towards the turn of the year.

Unemployment growing

The economic slowdown is increasingly affecting the labour market. Unemployment rose slightly year-on-year in November, employment growth slowed further.

In their first reaction to deteriorating order books, a series of large enterprises registered employees for short-time work, dismissed loaned employees and stopped hiring new staff. In seasonally adjusted terms, month-on-month employment growth came to a standstill. In November, 3,408,600 persons were in dependent employment, an increase by 51,300 from a year before. The year-on-year increase almost halved since June; due to the introduction of the obligation to immediately register newly hired staff the figure has been overdrawn by 20,000 to 30,000 since the beginning of the year. The registration of nursing staff, on the other hand, had hardly any influence on the number of employed persons, as nurses almost exclusively took up activities as self-employed.

With the economic downturn starting out with exports, it has hit male workers in the manufacturing sector particularly hard. Developments have been more stable in the services sector, with the number of employed women dampened less so far. Persons with a migration background have been affected to a more-than-proportional degree.

In November, 225,600 persons were registered as unemployed with the Public Employment Service, an increase by 2,000 compared with a year earlier. Including persons in vocational training programmes, the number of job seekers exceeded the year-earlier level by 3,200. The unemployment rate reached 6.2 percent (6 percent, seasonally adjusted) in November.

The number of vacant jobs was affected most by the lack of orders; in November, it was more than 11 percent lower than a year before. Being a leading indicator, the number of job vacancies thus signals a further worsening in labour market conditions towards the turn of the year.