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Cyclical Recovery in the Euro Area still Lacking Momentum

Business Cycle Report of March 2014

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Growth in the emerging market economies continues to provide only weak incentives for global business activity. While the US economy follows a path of solid growth, the recovery in Europe remains tentative. Demand and output in Austria are heading up, though the upturn is lacking momentum.

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The main incentives to global economic growth are currently coming from the USA. After an increase of 1 percent in the previous period, real GDP growth stayed at a lively 0.6 percent quarter-on-quarter in the last three months of 2013. China also enjoyed strong growth of 1.8 percent in the fourth quarter 2013. Yet, the pace has slowed from the previous quarter (+2.2 percent), while business surveys point to further deceleration.

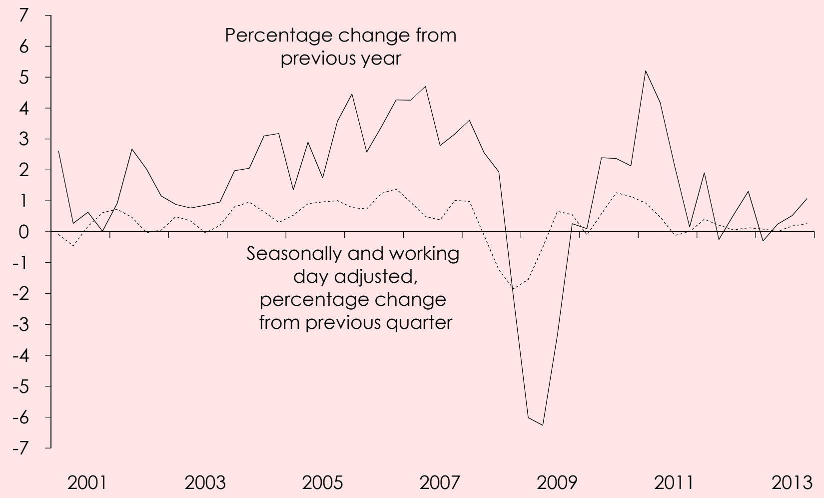
In Europe, the recovery has firmed somewhat. GDP in the euro area edged up by 0.3 percent in the fourth quarter 2013 from the previous period, in the EU 28 by 0.4 percent. Growth gained momentum in all major euro area economies as well as in Portugal, while the downturn in Greece abated, measured by year-on-year growth rates.

For the whole year 2013, Austria's GDP grew by 0.4 percent, according to preliminary figures. In the last three months, demand and output gained 0.3 percent in volume quarter-on-quarter. The cyclical recovery observed since mid-year 2013 has thus strengthened gradually.

Results from the regular WIFO Business Cycle Survey point to a continuation of the positive trend, even if the pace of the recovery is likely to remain below the one recorded in previous cycles. The WIFO Leading Indicator pointed towards modest expansion both in December and January, remaining upward bound also in February.

Headline inflation fell from 1.9 percent in December to 1.5 percent in January. Price pressure thus remained very low, albeit markedly above the euro-area average (+0.8 percent in January).

Figure 1: Growth of real GDP



Source: WIFO.

Table 1: Quarterly national accounts

	2012		2013			
	Third quarter	Fourth quarter	First quarter	Second quarter	Third quarter	Fourth quarter
	Percentage changes from previous quarter					
Adjusted for seasonal and working day effects, volume						
Final consumption expenditure	– 0.3	– 0.2	+ 0.1	+ 0.2	+ 0.2	+ 0.2
Households¹	– 0.1	– 0.0	+ 0.0	+ 0.0	+ 0.0	+ 0.1
General government	– 0.3	– 0.1	+ 0.1	+ 0.3	+ 0.3	+ 0.3
Cross capital formation	– 0.3	– 0.5	– 0.9	– 0.6	+ 0.1	+ 0.2
Gross fixed capital formation	– 0.3	– 0.5	– 0.3	+ 0.2	+ 0.0	+ 0.2
Machinery and equipment	– 1.4	– 1.0	– 0.2	– 0.1	– 0.6	– 0.3
Construction	+ 0.6	+ 0.3	+ 0.2	+ 0.2	+ 0.3	+ 0.3
Exports, goods and services	+ 0.8	+ 0.1	+ 0.4	+ 0.8	+ 1.0	+ 1.1
Goods	+ 0.7	– 0.6	+ 0.4	+ 0.8	+ 1.3	+ 1.3
Services	+ 1.0	+ 0.8	+ 0.7	+ 0.6	+ 0.5	+ 0.6
Imports, goods and services	– 0.2	– 0.3	+ 0.2	+ 0.7	+ 0.9	+ 0.6
Goods	– 0.0	– 0.6	– 0.0	+ 0.8	+ 0.9	– 0.1
Services	+ 0.3	+ 0.5	+ 0.5	+ 0.1	+ 1.5	+ 2.6
Gross domestic product	+ 0.1	+ 0.1	+ 0.1	+ 0.0	+ 0.2	+ 0.3
Manufacturing	– 0.7	+ 1.1	+ 0.4	+ 0.2	+ 0.3	+ 0.4

	2012	2013	2012		2013			
			Third quarter	Fourth quarter	First quarter	Second quarter	Third quarter	Fourth quarter
			Percentage changes from previous year					
Volume, chained prices								
Final consumption expenditure	+ 0.4	– 0.1	– 0.3	– 0.8	– 1.4	– 0.4	+ 0.7	+ 0.5
Households¹	+ 0.5	– 0.2	+ 0.1	– 1.1	– 0.9	– 0.7	+ 0.4	+ 0.3
General government	+ 0.2	+ 0.1	– 1.5	+ 0.2	– 2.8	+ 0.6	+ 1.6	+ 0.9
Cross capital formation	– 1.2	– 4.1	– 3.8	+ 7.1	– 7.5	– 7.0	– 0.6	– 2.4
Gross fixed capital formation	+ 1.6	– 0.9	+ 0.7	– 0.1	– 3.4	– 1.0	– 0.2	+ 0.5
Machinery and equipment	+ 2.1	– 3.1	– 4.1	– 2.1	– 7.4	– 1.8	– 2.3	– 1.1
Construction	+ 2.5	+ 0.7	+ 5.4	+ 1.4	+ 0.9	– 0.3	+ 0.9	+ 1.2
Exports, goods and services	+ 1.2	+ 2.8	+ 2.0	+ 0.4	+ 2.0	+ 3.7	+ 2.0	+ 3.4
Goods	+ 0.4	+ 2.6	+ 1.0	– 0.4	+ 0.8	+ 4.0	+ 1.8	+ 4.0
Services	+ 3.3	+ 3.1	+ 4.7	+ 2.5	+ 4.6	+ 3.1	+ 2.6	+ 2.1
Imports, goods and services	– 0.3	+ 0.6	– 1.7	– 0.2	– 2.2	– 0.0	+ 2.4	+ 2.2
Goods	– 1.4	+ 0.2	– 2.4	– 1.4	– 2.8	+ 0.0	+ 2.5	+ 1.2
Services	+ 4.5	+ 2.3	+ 1.2	+ 5.3	+ 1.0	– 0.3	+ 2.1	+ 6.0
Gross domestic product	+ 0.9	+ 0.4	+ 0.5	+ 1.3	– 0.3	+ 0.2	+ 0.5	+ 1.1
Manufacturing	+ 1.2	+ 1.2	+ 0.9	+ 0.8	– 1.9	+ 0.8	+ 2.4	+ 3.6
Gross domestic product, value	*+ 2.6*	*+ 2.0*	*+ 2.4*	*+ 3.6*	*+ 2.0*	*+ 1.8*	*+ 2.1*	*+ 2.1*

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

The pattern of rising unemployment in parallel with growing job opportunities characterised the labour market also in early 2014. In February, the number of persons in dependent active employment increased by 0.1 percent from the previous month, while seasonally-adjusted unemployment edged up by 0.1 percent as well. The seasonally adjusted unemployment rate remained unchanged at 7.9 percent (national definition).

1. US economy on a sustained path of robust growth

The US economy expanded by 1 percent in the third quarter 2013, and by another lively 0.6 percent in the last three months of the year. Leading indicators suggest that the favourable trend will continue in the coming months.

In the fourth quarter 2013, demand in the USA shifted markedly away from investment and towards private consumption and net exports. Having still increased by a buoyant 4 percent in the previous period, private investment gained only 1 percent in the fourth quarter. Residential building in particular suffered a setback from the strong pace of growth observed since early 2012. Demand for machinery and equipment, however, rose by a sizeable 1.8 percent.

With +0.6 percent quarter-on-quarter, consumption by private households, the most important demand component in the USA, posted the strongest gain since end-2011. Demand was lively for both, durable (+0.6 percent in volume) and non-durable (+0.9 percent) consumer goods. With disposable income stagnating at the level of the earlier period, the saving ratio declined from 4.9 percent to 4.5 percent.

Likewise, foreign trade provided a substantial contribution to GDP growth in the fourth quarter. While exports of goods and services grew by 2.3 percent in volume from the previous period, imports edged up by only 0.4 percent. The tendency towards a narrowing deficit in the foreign trade of goods and services, observed since the beginning of 2012, continued.

The Federal Reserve has kept its key interest rate at slightly above 0 percent by meanwhile five years. Lately, the bank has started to restrain its supplementary programme of bond purchases. Despite the extremely expansionary stance of monetary policy during the last years, inflation remains very low. In early 2014, the year-on-year increase in the consumer price index of 1.6 percent was barely higher than the 1.5 percent recorded in December 2013.

Unemployment has been heading down gradually since the end of the recession in mid-2009. After a slight decline to a rate of 6.6 percent in January 2014, it rose marginally to 6.7 percent in February.

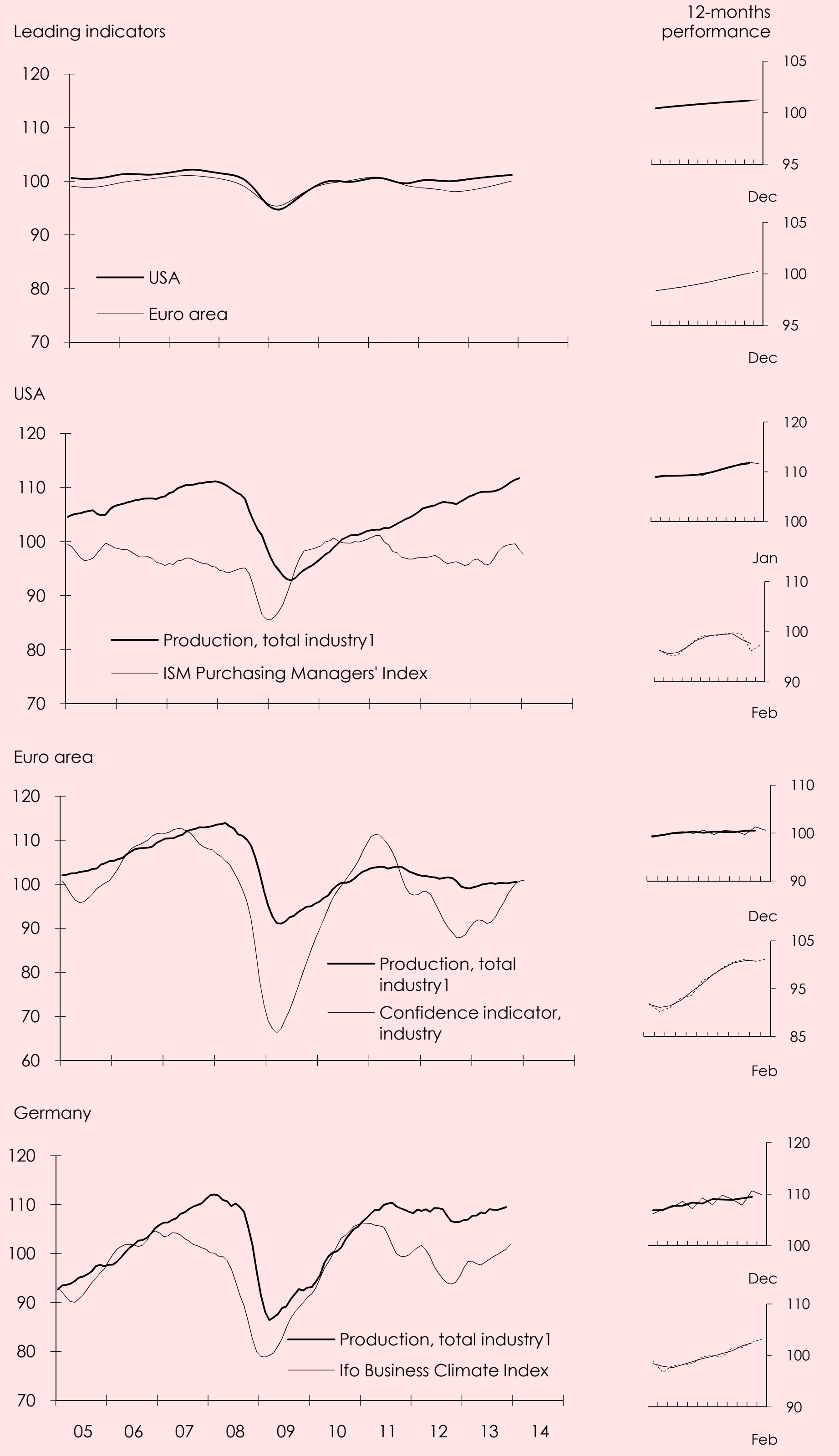
2. Slower growth in emerging markets

Whereas the expansion of the emerging markets had stimulated global business activity during the last years, these countries now appear to have lost the confidence of investors as capital flows have reversed in the last six months. This exerts considerable downward pressure on the currencies of the countries concerned. In order to stem further capital outflows, the Central Banks in a number of countries raised interest rates massively. Since the second half of 2013, the Brazilian Real, the Argentinian Peso, the Indian Rupee, the Turkish Lira and the Russian Rouble have been exposed to significant downward pressure vis-à-vis the dollar and the euro. Against the background of the escalation of the crisis in Ukraine, the depreciation of the Rouble has accelerated of late.

In the BRIC countries, economic activity has noticeably lost momentum. Demand and output stagnated in Russia both in the second and third quarter 2013, whereas in Brazil growth resumed towards the end of the year, after a setback in the third quarter. Growth of the Indian economy has decelerated markedly in the last eighteen months. China still enjoyed strong growth of 1.8 percent in the fourth quarter 2013, down however from the 2.2 percent recorded in the previous period; moreover, business surveys point to a further slowdown of activity.

Figure 2: 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.

3. Low interest rates worldwide fuelling stock markets

Stock market indices are still at peak levels. The unusually low interest rates in the advanced economies and stable commodity prices have sharply driven up demand for stock market assets.

The crisis on financial markets in the USA and Europe is yet unresolved. Central Banks still feel obliged to keep monetary policy at an expansionary stance, which explains the extremely low level of long-term interest rates. In this situation, government bonds and saving deposits yield but poor returns. Likewise, the narrow variation of commodity prices leaves little scope for speculative gains.

Against this background, demand for shares strengthened markedly in 2013, given also the rise in corporate earnings with the robust expansion of the real economy in the USA and some European countries. Moreover, economic agents' appetite for risk seems to have recovered from the sharp drop during the financial market crisis.

The Dow Jones Industrial Average at the end of February 2014 exceeded its year-earlier level by around 15 percent. In Europe, the Euro Stoxx rose by even 20 percent over the same period, mainly driven by the buoyant German stock market. The DAX climbed above 9,600 points at the end of February, an increase by some 25 percent year-on-year.

A slump in stock market values could once again unsettle the real economy in these countries. Although such danger exists, it is nevertheless low for several reasons: first, the price-earnings ratios are low due to the price hikes, but still in line with the low yields on alternative investments; hence, a massive shift in asset portfolios towards such alternatives would be rather unattractive. Second, the repercussions of a sharp asset price decline for the real economy may be smaller this time than in the past, as the time since the last slump in share prices and real estate values occurred is still short. After extended periods of rising share prices, investors become increasingly confident about the sustainability of the evidenced, though not yet realised, gain in their wealth and take their decisions accordingly. If in such a situation expectations are badly disappointed, the ensuing re-allocation of portfolios will drag down the real economy. In the current situation, most market participants should rather be aware of the volatility of such book profits. Thus, their economic decisions and actions may already incorporate the possibility of such wealth losses, with the actual incidence in the event turning out less damaging to the real economy.

4. Cyclical recovery in Europe broad-based, but still sluggish

Since the second quarter 2013, when the latest recession had been overcome, the EU economy has followed a stable growth path without activity gathering momentum. However, business surveys suggest that the upswing may soon gain strength.

Demand and output in the EU rose by an inflation-adjusted 0.4 percent in the fourth quarter 2013 from the previous period, broadly maintaining the pace of the earlier six months. It thus appears that the recession observed in late 2012 and early 2013 has been overcome. Yet, the pace of the recovery is slow, as expected by WIFO in its latest forecasts. Deviating from the typical pattern of a cyclical upswing, GDP growth has not accelerated over the last few quarters. The forward drive is held back by the still unresolved financial market crisis and by the restrictive stance of fiscal policy.

The revival of business activity is spreading also to the southern and western euro area periphery, where countries have been struggling with severe economic problems (Table 1). Spain has pulled out of recession, as GDP picked up by 0.1 percent in the third and by 0.2 percent in the fourth quarter 2013. In Portugal, quarterly growth strengthened from 0.3 percent to 0.5 percent. In Italy, the recovery is much more hesitant, although the trend is tentatively heading up: in the first half of 2013, the downward trend bottomed out and gave way to stagnation in the third quarter, followed by a slight increase of 0.1 percent in the fourth quarter. For Greece, seasonally adjusted GDP data are currently missing; the year-on-year comparison shows a marked deceleration of the downward trend from quarter to quarter.

The Irish economy expanded by 1 percent in the second quarter and by 1.5 percent in the third quarter 2013 (data for the fourth quarter are still unavailable). The Netherlands also appear to have overcome the stubborn recession caused by the burst of the real estate price bubble. GDP growth has since strengthened from 0.1 percent in the second, to 0.3 percent in the third and 0.7 percent in the fourth quarter 2013.

Table 2: Quarterly growth of GDP in selected EU countries, 2013

Adjusted for inflation, seasonal and calendar effects

	First quarter	Second quarter	Third quarter	Fourth quarter	First quarter	Second quarter	Third quarter	Fourth quarter
	Percentage changes from previous quarter				Percentage changes from previous year			
EU 28	− 0.1	+ 0.4	+ 0.3	+ 0.4	− 0.7	− 0.1	+ 0.2	+ 1.1
Euro area 18	− 0.2	+ 0.3	+ 0.1	+ 0.3	− 1.2	− 0.6	− 0.3	+ 0.5
Spain	− 0.3	− 0.1	+ 0.1	+ 0.2	− 1.9	− 1.6	− 1.1	− 0.2
Portugal[1]	− 0.3	+ 1.1	+ 0.3	+ 0.5	− 4.0	− 2.0	− 0.9	+ 1.6
Italy	− 0.6	− 0.3	± 0.0	+ 0.1	− 2.6	− 2.3	− 1.9	− 0.8
Greece[2]	.	.	.	.	− 5.5	− 3.7	− 3.0	− 2.6
Ireland[1]	− 1.1	+ 1.0	+ 1.5	.	− 1.8	− 1.5	+ 1.7	.
Netherlands[3]	− 0.3	+ 0.1	+ 0.3	+ 0.7	− 1.4	− 1.7	− 0.6	+ 0.7
Finland	− 0.2	± 0.0	± 0.0	− 0.3	− 2.8	− 1.3	− 0.9	− 0.5
Slovenia	+ 0.1	+ 0.2	+ 0.4	+ 1.2	− 3.1	− 1.7	− 0.8	+ 1.9
Slovakia[1]	+ 0.3	+ 0.3	+ 0.3	+ 0.4	+ 0.7	+ 0.8	+ 0.9	+ 1.3
Sweden	+ 0.8	± 0.0	+ 0.5	+ 1.7	+ 1.6	+ 0.7	+ 0.7	+ 3.1
Czech Republic	− 1.3	+ 0.3	+ 0.2	+ 1.6	− 2.3	− 1.7	− 1.2	+ 0.8
Hungary	+ 1.1	+ 0.3	+ 0.8	+ 0.6	− 0.1	+ 0.6	+ 1.7	+ 2.8

Source: Eurostat. – [1] Unadjusted for calendar effects. – [2] Seasonally unadjusted. – [3] Percentage changes from previous year: work-day adjusted.

The formerly highly successful Scandinavian economies have been facing problems for the last two years.

Whereas the critical situation in southern and western EU countries is improving gradually, the formerly highly successful Scandinavian economies are facing major cyclical problems. In Finland, the downward trend accelerated from –1 percent in 2012 to –1.4 percent in 2013, with GDP falling markedly year-on-year in all four quarters. While private consumption had still supported activity in 2012, all major demand components receded in 2013. Notwithstanding this, the harmonised rate of inflation in Finland at close to 2 percent in the last months has been one of the highest in the euro area. The current account and the government balance have both been in deficit for a couple of years. The Swedish economy, though spared from recession, is growing at a slower pace than in the past. Still, a rebound has been recorded for the fourth quarter 2013.

Austria's northern and eastern neighbours also enjoyed a revival of growth in the fourth quarter 2013. GDP in the Czech Republic jumped by 1.6 percent, after +0.2 percent in the previous period. In Slovakia, GDP climbed by 0.4 percent in volume, after +0.3 percent. The Hungarian economy expanded by 0.6 percent in the fourth quarter 2013. Slovenia may have ridded itself from recession: the negative year-on-year gap narrowed steadily in the first semester 2013, with growth resuming as from the middle of the year. In the third quarter, GDP rose by 0.4 percent from the earlier three months, in the fourth quarter by 1.2 percent.

Business surveys for the euro area indicate a lasting cyclical recovery. In February 2014, the Economic Sentiment Indicator rose for the tenth time in a row, albeit by a small margin. The still rather timid recovery will not be able to generate an early turnaround on the labour market; the euro-area unemployment rate has been close to 12 percent, unchanged over the last twelve months.

Inflation in the euro area has followed a downward trend since the end of 2011, the harmonised consumer price index hitting a low of 0.8 percent in January and February (according to the flash estimate) 2014. While food prices, including alcohol and tobacco (+1.5 percent) and service prices (+1.3 percent) posted above-average increases of late, inflation for industrial manufactures was subdued (+0.6 percent) and energy prices fell by 2.2 percent. Excluding food, alcohol, tobacco and energy items, which are usually subject to heavy price variations unrelated to the business cycle, the inflation rate stood at 1.0 percent. It is too early to talk about a trend towards deflation, but such danger would arise if the downward trend were to continue.

5. Recovery also in Austria sluggish

Austria's GDP increased by 0.3 percent in the fourth quarter 2013, slightly more strongly than before. However, the momentum of previous periods of cyclical upturn is still lacking.

Total output of the Austrian economy expanded by 0.3 percent in the fourth quarter from the previous period. Growth has thus firmed once again, matching the euro area average. For the whole year 2013, growth of GDP was 0.4 percent.

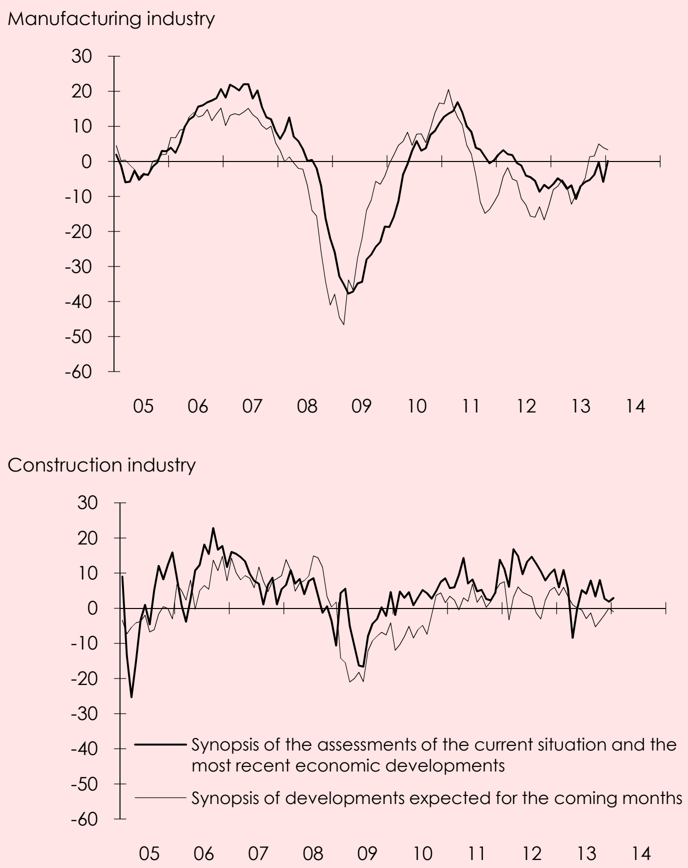
The revival of exports was the main driver in the fourth quarter. Investment also edged up, while private consumption continued its quasi-stagnation (+0.1 percent).

Business surveys suggest that the upward trend will continue in the months to come. In February 2014, the WIFO Leading Indicator which consists of several components showed a reading that was well above the threshold signalling expansion, even if the gain from the earlier period was marginal.

The regular WIFO Business Cycle Survey confirms the persistently slow pace of domestic output growth. Although firms' assessment of the current business situation turned markedly more positive in February, expectations for the next few months were hardly more optimistic.

Figure 3: 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.

Present conditions were considered more favourable mainly by manufacturers and construction firms. The latter benefited, however, from the unusually mild winter, such that the increase in output was probably exaggerated to some extent by projects carried forward. This is confirmed by the somewhat less upbeat expectations of construction firms for the near future.

The cyclically highly sensitive manufacturing sector expressed not only satisfaction with current conditions, but also rising confidence for the next few months. This goes for producers of consumer goods, but even more for those of investment goods and semi-manufactures.

In the first half of the winter season (November 2013 to January 2014), the number of overnight stays in tourism rose 0.4 percent from one year ago (domestic customers +0.6 percent, foreign visitors +0.4 percent; from USA +11 percent, Russia +4 percent, Switzerland +3 percent). Because of the trend towards rental of apartments, gross earnings trailed behind the increase in overnight stays, falling by 0.7 percent in nominal and by 2.3 percent in real terms. On a regional basis, tourism revenues from November 2013 to January 2014 exceeded the year-earlier level only in Vienna and Styria significantly; they remained flat in Burgenland and diminished in Vorarlberg somewhat less than on national average. Limited losses were recorded in Carinthia, Upper Austria and Salzburg, more substantial ones in Tyrol and Lower Austria.

Although snow conditions in the winter season were relatively poor in some areas, the number of overnight stays in tourism rose slightly. Gross earnings, however, fell somewhat.

5.1 Trade and consumption still holding back business activity

According to the consumer climate indicator of the European Commission, confidence of Austrian consumers barely changed in February from the previous month, the balance of positive and negative opinions still being negative (–6.5 percentage points). Yet, the labour market outlook, a component of the climate index, was judged more favourably for the second time in a row. However, respondents revised down their expectations for the overall economic situation in the next 12 months.

Households' readiness to buy durable consumer goods seems still muted in early 2014, as suggested by the decline in new private car registrations (–22.4 percent year-on-year in January). Figures may, however been distorted by the imminent change in the car registration tax as from 1 March 2014 (the increase by 8.2 percent in December 2013 possibly including pre-emptive purchases or potential buyers waiting for special offers from car dealers).

According to preliminary data from Statistics Austria, retail sales (excluding motor car sales) picked up early this year, both in nominal and inflation-adjusted terms, driven by stronger demand for food items, while non-food sales remained flat. Opinions expressed by retailers in the WIFO Business Cycle Survey of February 2014 do not point to a noticeable improvement.

5.2 Inflation heading down

Consumer prices in Austria rose 1.5 percent above the year-earlier level in January 2014, driven by price increases for food and goods in the categories "housing, water, energy" and "restaurants and hotels". The biggest jumps were recorded for communication (+5.5 percent) and alcoholic drinks and tobacco (+3.6 percent). Transportation prices came down by 0.4 percent, thanks to fuels becoming cheaper once more. Sluggish demand also weighed on prices for clothing and shoes (–0.1 percent).

Domestic headline inflation abated to 1.5 percent in January 2014. While energy items became once again cheaper, prices for services and food drifted up strongly.

Austria's harmonised inflation rate (+1.5 percent) continues to significantly exceed the euro-area average (+0.8 percent) and also the rate for Germany (+1.2 percent). Like in the past, this is mainly due to price pressure in the category "hotels, cafés and restaurants" which explains almost 0.3 percentage points of the difference.

Prices for the "micro" basket of daily purchases went up by 3.9 percent year-on-year, on account of the high statistical weight of food items. Items typically bought on a weekly basis ("mini" basket) went up by only 1.3 percent, owing to the price cuts for fuel.

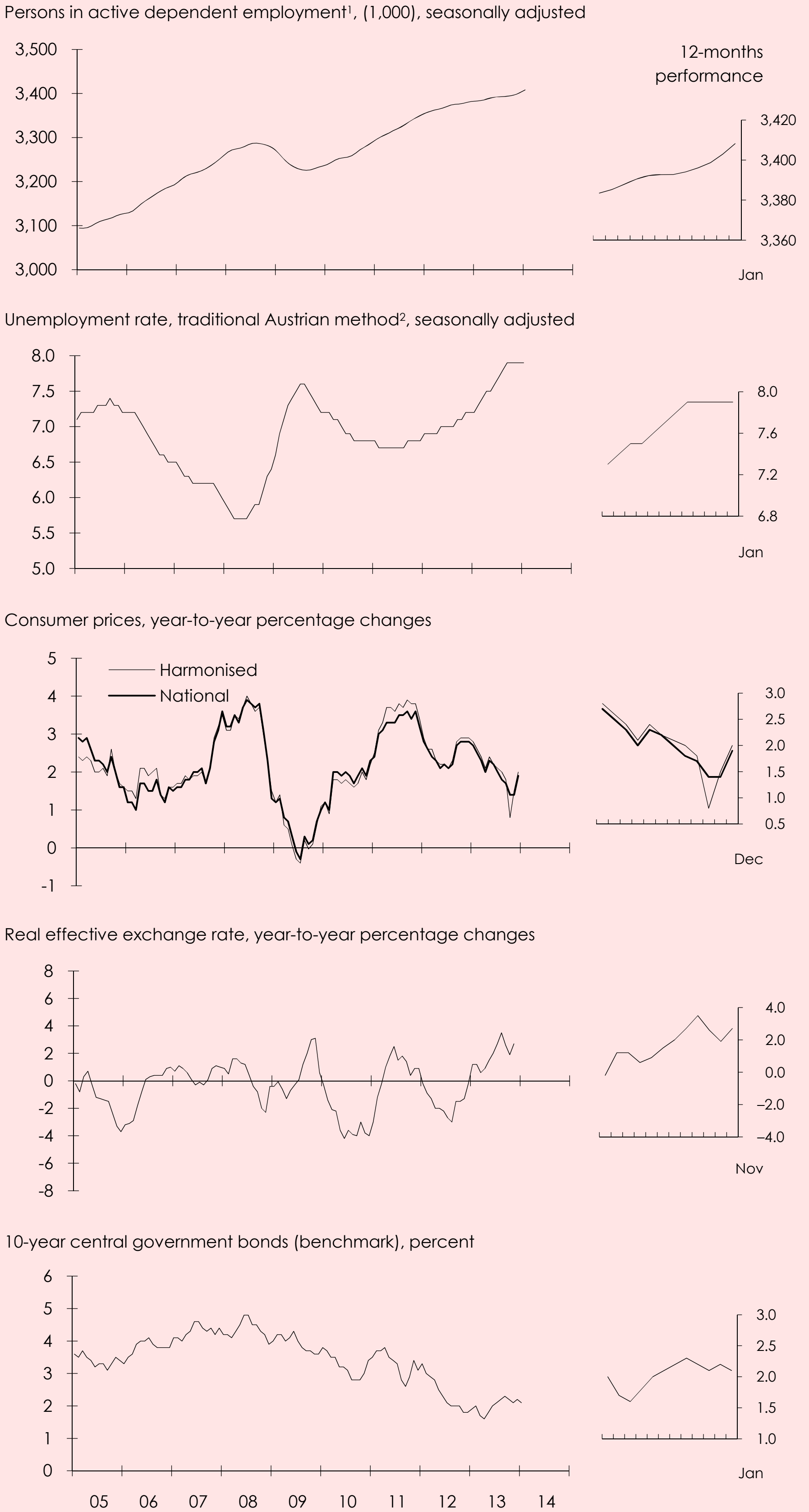
5.3 No cyclical revival on the labour market

The labour market is showing no signs of a turnaround so far. Seasonally-adjusted employment growth (persons in dependent active employment) has slowed from 0.2 percent in January to 0.1 percent in February. Compared with one year ago, 26,400 new jobs (+0.8 percent) have been created in net terms.

The sluggish recovery has so far not reached the labour market. Employment growth remains subdued, and unemployment increased further in February.

Labour supply remained buoyant in February, which complicates a reduction in unemployment, given the slow pace of the recovery. The number of registered unemployed was 30,300 or 9.3 percent higher in February than last year and edged up by 0.1 percent seasonally adjusted from January.

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.

Due to seasonal factors, the jobless rate (national definition) eased from 9.7 percent in January to 9.4 percent in February; year-on-year, it rose by 0.7 percentage points. The seasonally-adjusted rate stood at 7.9 percent in both months. The EU-wide harmonised unemployment rate for Austria declined by a seasonally-adjusted 0.1 percent in January from December. With a jobless rate of 4.9 percent of the labour force, Austria should still hit a record low among the EU member countries.