

Austria's economy will grow by 2¾% in 2017

Gerhard Fenz,
Friedrich Fritzer,
Martin Schneider¹

In the first half of 2017, Austria's economy gathered further momentum. With growth rates by 0.8% in both the first and the second quarters, Austria recorded its strongest economic growth in six years. The broad-based cyclical upswing is being underpinned by both domestic and foreign demand and will continue in the second half of the year. Based on its quarterly forecasting exercise, the Oesterreichische Nationalbank (OeNB) expects real GDP to expand (quarter on quarter) by 0.7% in the third quarter and by 0.6% in the fourth quarter of 2017. For the year as a whole, economic growth in Austria will thus come to 2¾%. Compared with the OeNB's June 2017 outlook for GDP growth, this implies an upward revision of 0.5%. Distinctly higher growth rates were last recorded in the boom period of 2006 and 2007, when economic growth accelerated to 3½%.

1 Dynamic rise in goods exports after stagnation in 2016

The current outlook for the global economy and global trade has stabilized and improved further. In particular, growth expectations for Central, Eastern and Southeastern Europe (CESEE), which is an important export market for Austria, have been revised upward recently. Moreover, numerous growth risks affecting businesses' and consumers' confidence and their propensity to invest have fallen over the past few months. For example, potential political risks within the euro area have not materialized and so far, Brexit has not had a significant negative impact, either.

Austrian exporters benefited from these external developments. Having stagnated in 2016, nominal goods exports rose by almost 10% during the first five months of 2017. The regional breakdown of exports shows that the upsurge in exports is broadly based across regions. In the first five months of 2017, Austrian exports to France went up by 58% (driven by a one-off effect in January related to pharmaceutical products) and exports to Russia (+31%), the Netherlands (+14%) and

Sweden (+13%) increased significantly as well.

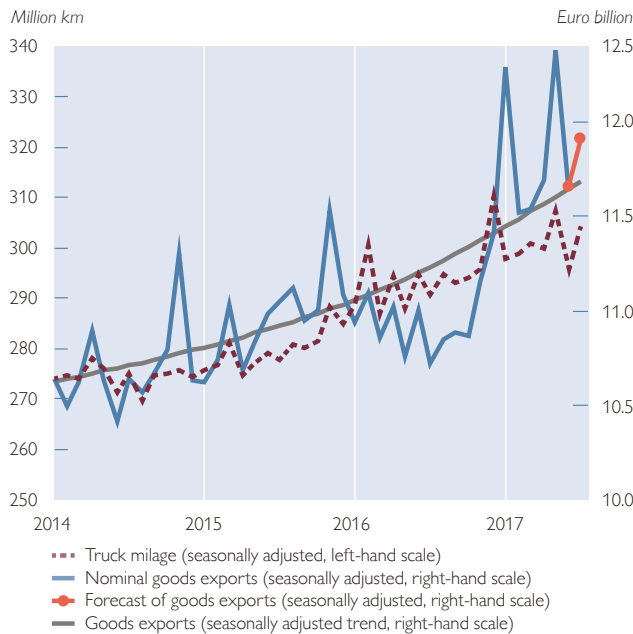
Moreover, Austrian export developments reflect the economic recovery in CESEE. While exports to the ten CESEE EU Member States² almost came to a standstill over the past five years, they accelerated noticeably in the course of 2017. For Austria's export industries, the rise in exports to the Czech Republic (+11%), Hungary (+10%) and Slovakia (+8%) is of particular importance. Out of the 20 biggest export markets, a negative trend was only recorded for Switzerland (-4%), the United Kingdom (-3%) and Turkey (-3%). Other than chemical products, it was mostly manufactured goods and machinery and vehicles that fueled exports. The OeNB's August 2017 export indicator, which is based on truck toll data, indicates continued dynamic export growth in June and July. On average, goods exports grow by approximately 7%, or even more than 8% when adjusted for seasonal and working-day effects, in these two forecast months. For the months ahead, businesses' estimates for new export orders indicate a stabilization of export growth at the current high levels.

¹ Oesterreichische Nationalbank, Economic Analysis Division, gerhard.fenz@oebn.at, friedrich.fritzer@oebn.at, martin.schneider@oebn.at.

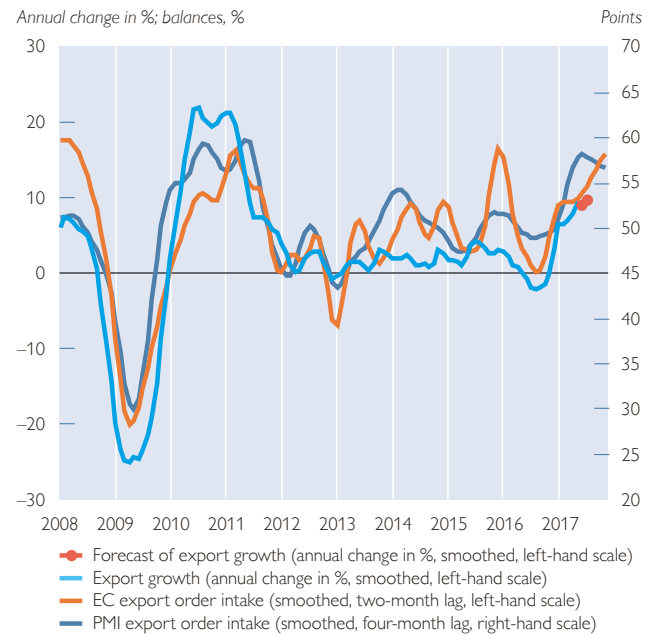
² Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

Austria's economy overcame stagnation in trade

Truck milage and goods exports (seasonally and working-day adjusted)



Leading indicators for foreign trade



Source: ASFINAG, OeNB.

Services exports benefit from highly favorable developments in Austrian tourism. 72 million overnight stays in the first six months of 2017 set a new record high. In particular, the beginning of the summer tourist season (May and June) saw a welcome 5.9% increase in the number of overnight stays. Overnight stays of foreign tourists made an above-average contribution to this increase, climbing by 7.4%. Overall exports are expected to make an even larger contribution to economic growth in Austria in the second half of the year than in the first.

2 Robust industrial output in the first half of 2017

Favorable exports are also a major stimulus to the domestic manufacturing sector, which in addition benefits from strong domestic demand. According to national accounts data, industrial pro-

duction increased year on year by 5% in real terms in the second quarter of 2017, which means it grew twice as fast as Austria's economy as a whole. Such above-average growth relative to the pace of the overall economy is typical of boom periods. In 2000 and in 2006–2007, for instance, industrial production posted growth rates of around 8%.

Positive survey results suggest that industrial activity will remain strong throughout the second half of the year (see figures above). The Bank Austria Purchasing Managers' Index (PMI) and the European Commission's Industrial Confidence Indicator are both close to their historic highs. The PMI rose to 60 points in July and thus clearly exceeded the 50 point threshold indicating an expansion in industrial production. Also, the European Commission's Industrial Confidence Indicator stood at 7.5 on balance, which is distinctly above its

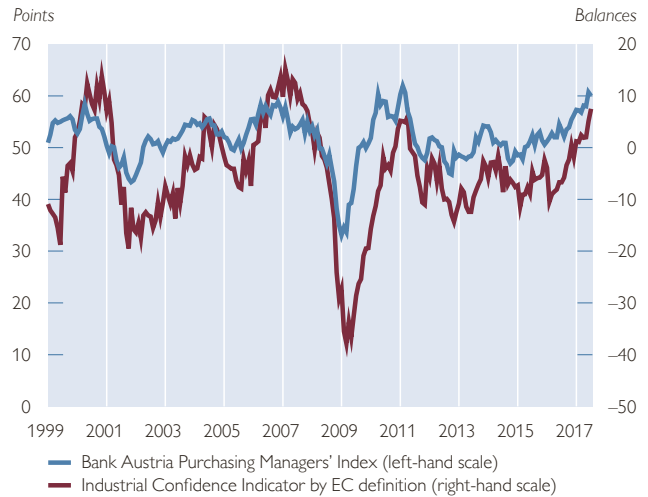
Chart 2

Strong industrial output

Gross value added



Confidence indicators



Source: Eurostat, Bank Austria.

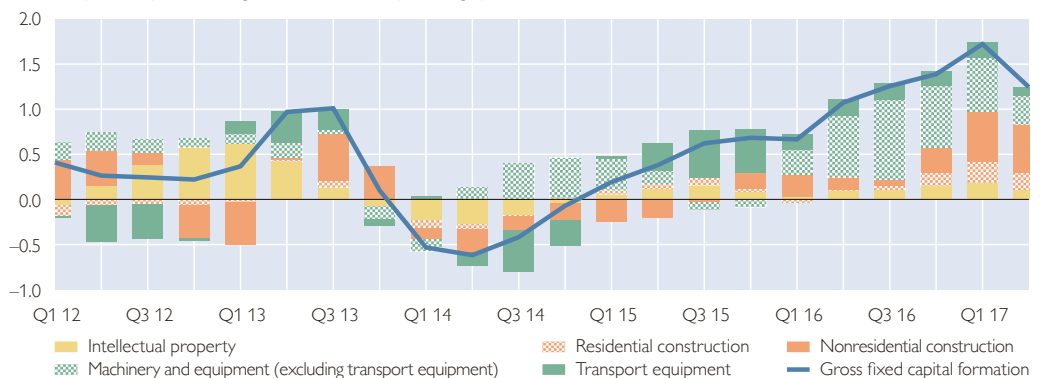
long-term average of -5.0 . According to Statistics Austria, new export orders increased considerably by more than 10% from January to May 2017. In mid-2017, too, industrial firms gave a very favorable assessment of order books. However, surveys show that order books appear to be stabilizing at a high level. The PMI indicates that growth in new orders has recently eased somewhat. This slowdown is mainly

attributable to the slightly weaker growth in foreign orders. However, the ratio of new orders to inventories still indicates strong production growth in the industrial sector. Although the industrial cycle may have peaked in mid-2017, a significant decline in growth is not on the cards. Austria's industrial sector will thus continue to post robust growth in the months ahead.

Chart 3

Investment cycle peak in the first half of 2017

Growth to previous quarter in %, growth contribution in percentage points



Source: Eurostat, OeNB.

3 Equipment investment has reached its cyclical peak – Indicators for greater investment in residential construction

Additional investment has become necessary to boost output levels. In 2016, investment in machinery and vehicles had already risen considerably and in the first half of 2017 it went up again. By historical standards, the current equipment investment cycle is thus above-average in terms of volume and duration, rendering a further acceleration unlikely in the second half of the year. Capacity utilization rates stood at 86.6% in the second quarter, well above the long-term average of 85.1%. This implies a need for expansion investment. While the need for replacement investment was the main investment driver at the beginning of the current cycle, it is expected that expansion investment will play a major role from now on.

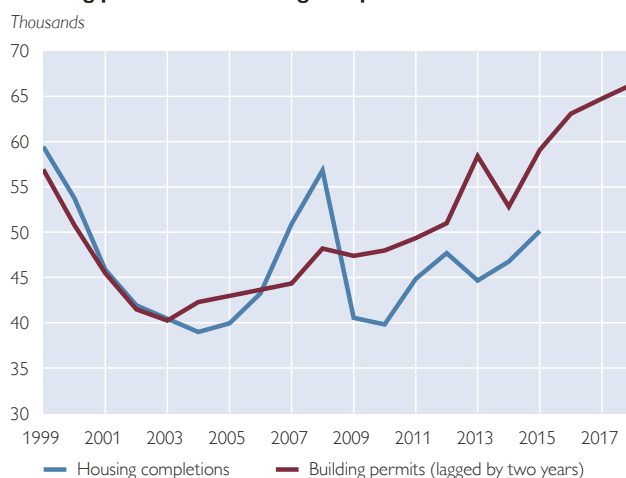
By contrast, construction investment is expected to rise. Confidence in the construction sector has grown con-

siderably in recent months. In July, the European Commission's confidence indicator for the construction sector reached 9.8 points, not only remaining above its long-term average of -16.9 points, but also hitting a record high. This rise in confidence is being reflected in growing construction activity, as reported by firms, and higher demand. The number of building permits is also rising more strongly than usual, reaching 66,000 in 2016, which is the highest number in the European Union when measured in terms of population. In view of these positive developments, the ongoing favorable funding conditions and the rising real estate prices, the (real quarter-on-quarter) growth of +1.0% in the second quarter was relatively muted, thus leaving room for a stronger expansion of residential construction activity in the coming quarters. Overall, firms' investment activity will remain robust in the coming months, given the upward trend in industrial and construction activity.

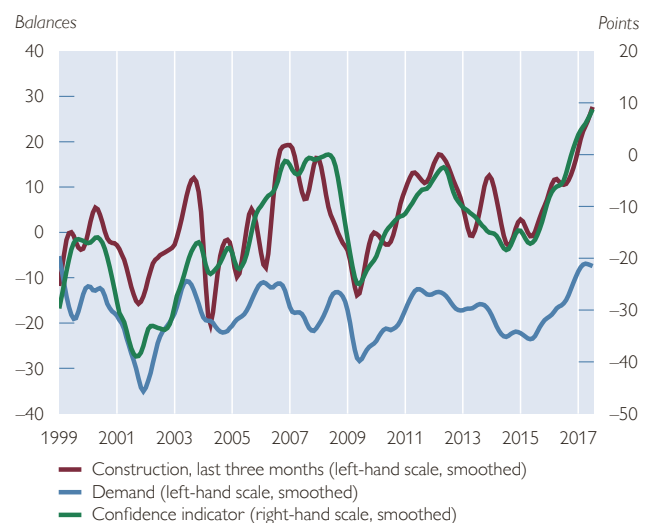
Chart 4

Leading indicators predict extended residential construction in the coming quarters

Building permits and housing completions



Confidence indicators



Source: Eurostat, OeNB.

Table 1

Key indicators for the Austrian labor market

	Payroll employment		Unemployed persons		Unemployment rate in %			Registered job vacancies		Persons in training programs	
	Thousands	Annual change in thousands	Thousands	Annual change in %	AMS definition (NSA ¹)	AMS definition (SA ²)	EU definition (SA)	Thousands	Annual change in %	Thousands	Annual change in %
2014	3,503	+20	319.4	+11.2	8.4	8.4	5.6	26,320	-0.2	75,317	+2.5
2015	3,535	+31	354.3	+11.0	9.1	9.1	5.7	29,251	+11.1	65,126	-13.5
2016	3,587	+52	357.3	+0.8	9.1	9.1	6.0	40,277	+37.7	67,210	+3.2
Q3 16	3,654	+48	324.8	+0.5	8.2	9.1	6.1	43,140	+33.5	61,962	+1.4
Q4 16	3,594	+58	369.0	-0.8	9.3	9.0	5.8	40,899	+32.8	61,962	-7.1
Q1 17	3,579	+59	392.3	-1.8	9.9	8.8	5.7	49,230	+39.3	74,481	+8.2
Q2 17	3,646	+65	320.0	-4.8	8.1	8.6	5.3	58,812	+41.0	74,426	+7.0
Feb. 17	3,576	+60	400.6	-1.3	10.1	8.8	5.8	49,383	+37.7	75,167	+7.1
Mar. 17	3,616	+60	354.1	-3.7	8.9	8.7	5.7	53,142	+44.5	76,686	+7.9
Apr. 17	3,605	+62	337.9	-4.5	8.6	8.7	5.4	55,530	+41.1	75,760	+7.0
May 17	3,648	+67	318.0	-4.9	8.0	8.6	5.2	59,858	+43.9	76,489	+7.6
June 17	3,684	+67	303.9	-5.0	7.6	8.6	5.2	61,048	+38.1	71,029	+6.3
July 17	3,728	+68	307.2	-4.4	7.6	8.6	x	65,038	+48.5	63,195	+8.2

Source: Main Association of Austrian Social Security Institutions, Austrian Public Employment Service (AMS), OeNB.

¹ NSA = Non-seasonally adjusted

² SA = Seasonally and working day adjusted

4 Private consumption continues to be a major driver of growth despite fading one-off effects

Besides the buoyant investment activity, the stable consumption growth is also indicative that the recovery has broadened further. With the fading of the positive stimuli related to the tax reform that took effect in early 2016 and an increase in inflation on the back of rising crude oil prices, consumption growth slowed slightly in the first half of 2017.

The excellent cyclical position of the economy is also clearly reflected in the labor market, with the number of payroll employees growing by more than 60,000, or 1.8%, in the first half of 2017. This growth is broad-based across sectors. The rising number of jobs in the industrial sector (+2.7%) and the construction sector (+1.8%) is particularly welcome, since most jobs in these sectors are full-time.

The number of registered unemployed individuals decreased steadily in the first half of 2017. On average, there

were almost 12,000 fewer unemployed than during the same period a year earlier. In July 2017, 307,000 individuals were searching for a job, and 63,000 individuals were in training and thus not registered as unemployed. Compared with July 2016, the unemployment rate (national definition) fell by half a percentage point to 7.6% (and 8.6% seasonally adjusted). According to Eurostat, the decline in the unemployment rate was even stronger, falling from 6.3% in June 2016 to 5.2% in the same month the following year. However, the number of older workers registered as unemployed and the number of long-term unemployed continues to rise.

In all likelihood, the Austrian labor market will continue to improve in the second half of 2017. The bright economic prospects and the sharp increase in the number of vacancies (+48% in July) reported by the Public Employment Service Austria (AMS) indicate that employment growth will be as strong in the second half of the year as it was in the first.

Table 2

Outlook for Austrian real GDP for the third and fourth quarter of 2017 (seasonally and working-day adjusted)

Q1 15	Q2 15	Q3 15	Q4 15	Q1 16	Q2 16	Q3 16	Q4 16	Q1 17	Q2 17	Q3 17	Q4 17
Quarterly change in %											
+0.3	+0.3	+0.2	+0.3	+0.4	+0.3	+0.5	+0.6	+0.8	+0.8	+0.7 ¹	+0.6 ¹
Annual change in %											
+0.6	+0.7	+0.9	+1.2	+1.2	+1.2	+1.5	+1.8	+2.2	+2.7	+2.9 ¹	+2.9 ¹
2015				2016				2017			
+0.9				+1.5				+2.7 ¹			

Source: OeNB's Economic Indicator of August 2017, Austrian Institute of Economic Research (WIFO).

¹ Forecast.

5 OeNB's short-term indicator: Austria's economy will grow by 2¾% in 2017

Consumption growth will remain stable in the second half of 2017 and, coupled with the ongoing rise in investment activity, will result in domestic demand being a strong contributor to growth. Together with the improved outlook for export activity, there is a very good chance that Austria's economy will grow considerably in 2017. Based on its quarterly economic indicator published in August 2017, the OeNB expects real GDP to grow (quarter on quarter) by 0.7% in the third quarter of 2017 and by 0.6 % in the fourth quarter. This implies an upward revision to third-quarter growth of 0.1 percentage points from the last publication in May 2017. For the year as a whole, economic growth will thus stand at 2¾%. Distinctly higher growth rates were last recorded in the boom period of 2006 and 2007, when economic growth accelerated to 3½%. The risks to this forecast are broadly balanced. In the event that external risks (unclear political situation in the U.S.A., Brexit negotiations, geopolitical tensions, ...) materialize, growth will be lower. Having said that, the recovery of the

euro area could gather even more pace and, in turn, boost the contribution of net exports. In addition, stronger than expected domestic demand is not to be ruled out.

6 Falling crude oil prices and the appreciation of the euro have dampened Austria's inflation rate in recent months

HICP inflation in Austria declined from 2.3% in April 2017 to 2.0% in July 2017, while core inflation (HICP excluding energy and unprocessed food) remained almost stable, at 2.2%, in the same period. The decline in headline inflation was due mainly to the drop in HICP energy inflation, from 2.8% in April to -0.5% in July 2017, on the back of lower crude oil prices in US dollars terms and the appreciation of the euro against the US dollar. Moreover, regional electricity suppliers have cut electricity prices in recent months. Conversely, food inflation (including tobacco and alcoholic beverages) went up significantly from April to June 2017 (April 2017: 1.5%; July 2017: 2.7%). This increase was primarily attributable to price hikes in dairy products. After bottoming out around a year ago, producer prices for

dairy products have risen significantly in both Austria and Europe. This is probably due to the increase in demand for dairy products.³ Services inflation, which stood at 2.9% in July 2017, is still the key driver of inflation. In recent months, however, it has remained broadly stable. In particular, the prices of tourism-related services have decreased slightly, but this was offset by a rise in rents (hike in benchmark rents) and in administrative services prices in recent months. Non-energy industrial goods inflation fell from 1.0% in April 2017 to 0.8% in July 2017, mostly owing to the volatile clothing and footwear components. Excluding clothing and footwear, non-energy industrial goods inflation has remained broadly stable since April 2017.

7 The OeNB's current inflation forecast: Decline in inflation from 2.0% in 2017 to 1.7% in 2018

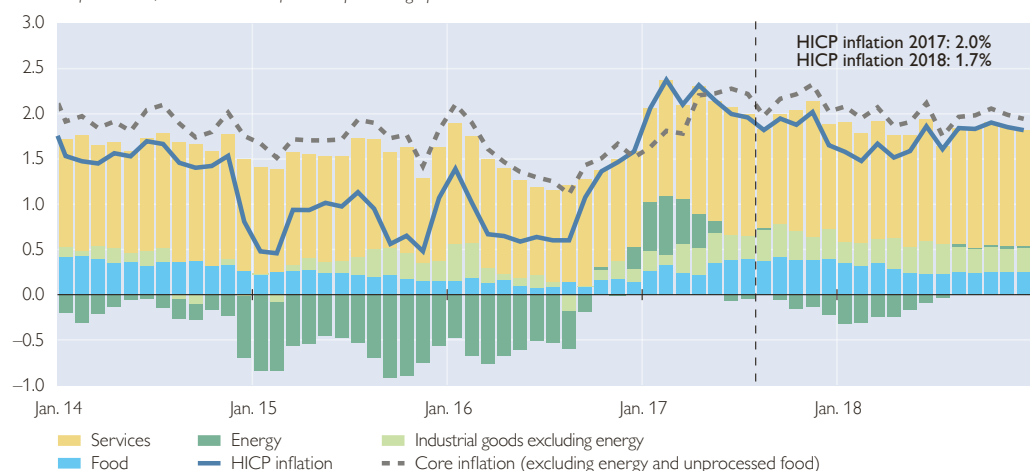
Based on the OeNB's current inflation forecast, we expect HICP inflation to stand at 2.0% in 2017 and to fall to an average of 1.7% in 2018.

These developments will be driven mainly by energy prices during the forecasting period, with around 80% of the decline in inflation being attributable to the HICP energy component. However, the processed food component (including alcoholic beverages and tobacco) will also curb inflation in 2018. With regard to the special aggregates of the HICP, unprocessed food inflation will increase during the forecasting period as a result of the normalization of unprocessed food inflation, which is currently low compared with the medium-term figures.

Chart 5

Contribution of components to Austrian HICP and core inflation

Annual inflation rate; contribution to inflation in percentage points



Source: Statistics Austria, OeNB.

³ According to the latest survey data (RollAMA/AMA Marketing), sales of dairy products went up in the first quarter of 2017 compared with the same period in 2016. At the European level, a significant increase in exports of dairy products to non-European markets was recorded in the first months of 2017 (see European Commission, Short-term outlook for EU agricultural markets in 2017 and 2018).