

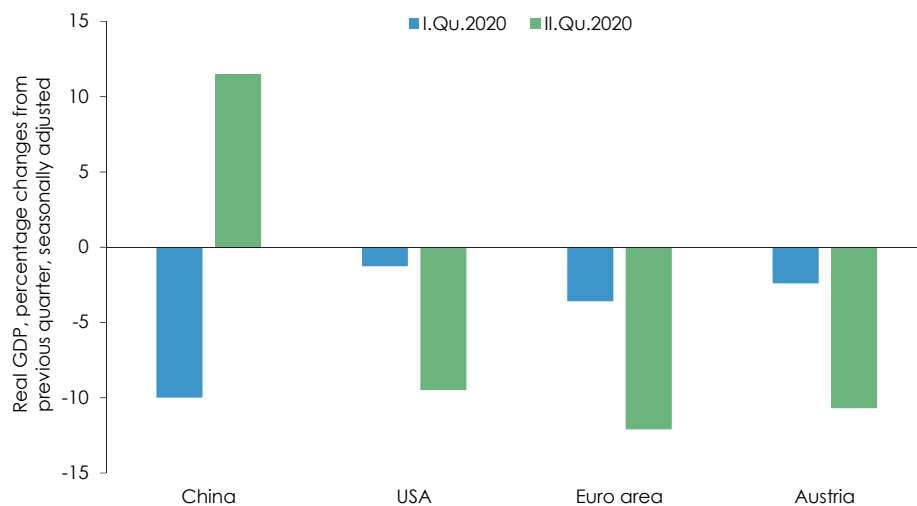
Economic Recovery is on the Horizon – High Economic Risks Due to Rising COVID-19 Infections

Business Cycle Report of August 2020

Christian Glocker

- In Austria, supply constraints to contain the COVID-19 pandemic and the collapse in demand in the first half of the year resulted in a significant reduction in economic output.
- Among the euro area countries, economic output fell particularly sharply in Italy, France and Spain.
- After China had lifted restrictions to a very large extent in the first quarter, economic output rose sharply in the second quarter.
- Since the COVID-19 pandemic broke out earlier in China than in the euro area and the USA, and China therefore took measures to contain it earlier and also lifted them again, the time pattern of economic development shifted in relation to the euro area and the USA.

International comparison of economic development in the first and second quarter 2020



Economic development in Austria follows the same time pattern as in the USA and in the euro area, while GDP in China already increased again in the second quarter of 2020 (Source: Eurostat; WDS – WIFO-Datasystem, Macrobond).

"Supply restrictions and the slump in demand caused by the lockdown resulted in a massive reduction in economic activity in many countries. After the lifting of measures to contain COVID-19 infections, economic activity in the individual countries resumed asynchronously. This characterises the internationally varying dynamics"

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In Austria, economic output fell in the first half of 2020 due to the measures taken to contain the COVID-19 pandemic. A decline of 2.4 percent compared to the previous period in the first quarter was followed by a contraction of 10.7 percent in the second quarter (seasonally adjusted according to Eurostat standard). Although companies continue to assess the current situation unfavourably in surveys, expectation indicators in particular have improved. Economic risks have recently been pointing more strongly downwards again due to the recent increase in the number of infections.

JEL-Codes: E32, E66 • **Keywords:** Business Cycle, Economic Outlook, Forecast

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The supply constraints in connection with the COVID-19 pandemic and the loss of demand from home and abroad led to a contraction in economic output in Austria in the first half of the year. While the decline in private consumption due to restrictions in trade and many service sectors significantly dampened GDP, investment and export activities were also restricted. Concerning the production approach, wholesale and retail trade, repair of motor vehicles and motorcycles, transportation and storage, accommodation and food service activities were the main drivers of the decline in economic output, accounting for almost half of the GDP decline in the second quarter.

In the euro area, GDP in the second quarter remained 12.1 percent below the previous quarter's result. Economic output fell particularly sharply in Italy, France and Spain. In the USA, gross domestic product declined by 9.5 percent in the second quarter. In contrast, economic output in China expanded strongly in the second quarter following a drop in the first quarter.

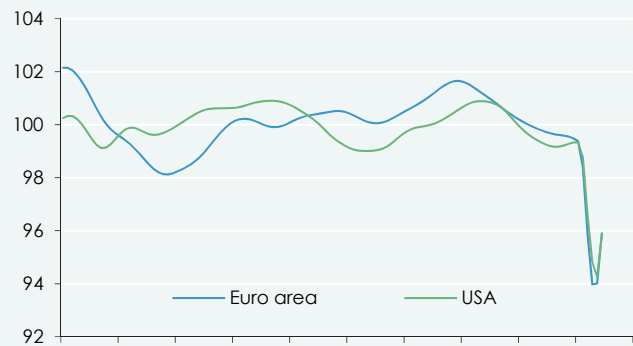
The leading indicators relevant to the Austrian economy suggest that the decline in economic output due to the COVID-19 pandemic reached a trough in April 2020. The survey data point to an improvement in both industry and the service sector since May. While expectations are on the upside, the current situation is still mainly assessed pessimistically.

The effects of the measures to contain the pandemic are hitting the labour market hard. The situation in Austria eased somewhat until July, but overall it remains precarious. According to preliminary estimates, the number of persons in active dependent employment in July was 88,000 lower than in the previous year (-2.3 percent), the number of unemployed persons registered with the Public Employment Service Austria (AMS) was 112,200 higher (+41.3 percent), including persons in training 107,300 (+33.0 percent). According to the national definition, the seasonally adjusted unemployment rate is therefore likely to have been 10.7 percent in July.

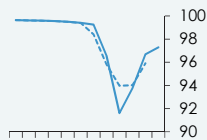
Figure 1: International Business Climate

Seasonally adjusted, 2015 = 100, 3-month moving average

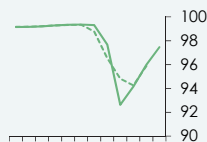
Leading indicators – amplitude



12-month performance

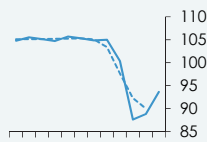
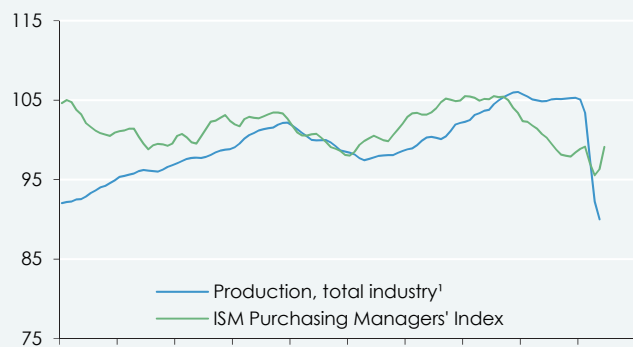


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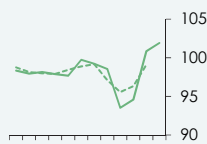


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USA

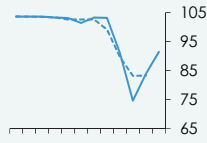


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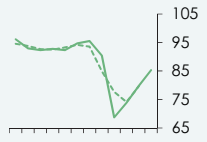


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Euro area

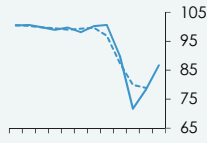
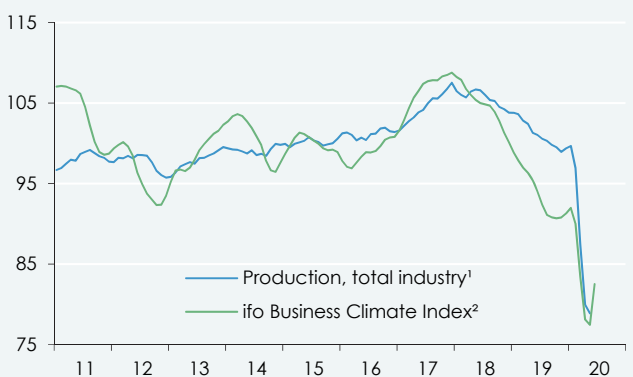


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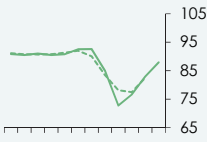


Jul

Germany



Jun



Jul

Source: European Commission, Deutsche Bundesbank, ISM (Institute for Supply Management™), ifo (Institute for Economic Research, Munich), OECD. – ¹ Excluding construction. – ² Manufacturing.

1. Slump in the global economy

The global economy collapsed in the first half of 2020 as a result of measures to contain the COVID-19 pandemic. The leading indicators already give a positive outlook, but the recent increase in the number of infections observed in many countries poses a considerable economic risk.

After the easing of restrictions, the US economy is slowly recovering. The spread of infections is not yet under control and thus constitutes a considerable economic risk.

China's economic output rose significantly in the second quarter of 2020. However, the foreign trade environment is slowing down the recovery.

In the euro area, GDP in the second quarter fell by 12.1 percent compared to the previous quarter. Economic output fell particularly sharply in Italy, France and Spain. However, the leading indicators are already giving a positive outlook.

While policymakers around the world are relaxing measures to contain the risk of infection, economic recovery remains uneven and uncertain. The outlook continues to be dominated by the course of the COVID-19 pandemic. The number of new infections continues to rise worldwide, especially in the USA and Latin America, as well as in several other emerging markets (e.g. India and South Africa). At the same time, restrictive measures are being eased in most countries. Against this background, it is difficult to assess the global economy.

According to various leading indicators based on company surveys, the global economy has already passed the bottom of the recession. The global Purchasing Managers' Index (PMI) continued to recover in July from its low in April and points to a favourable economic trend – in some countries it is now already above the 50-point threshold, which indicates that the economy is expanding. Both industrial production and business activity in the services sector are likely to increase.

According to the CPB, world trade remained weak in May, suggesting an exceptionally sharp decline in the second quarter. In recent months, the course has been very much in line with the scale and rigour of global containment measures. However, leading indicators are already pointing to an improvement. For example, the RWI Container Throughput Index has already risen sharply recently. Moreover, the partial indicator of export orders in the Global Purchasing Managers' Index in June signalled an increase in world trade.

The development of crude oil prices was determined by the worldwide increase in demand following the easing of COVID-19 restrictions. At the same time, however, supply was reduced, so that crude oil prices have risen markedly in recent months. They stabilised in July, with Brent crude oil trading at around 43 \$ in July. This development was largely influenced by the "OPEC+" agreement (i.e. the pact between the major crude oil producers) at the beginning of May to reduce supply by almost 10 million barrels per day and by significant production shutdowns in the USA.

1.1 Loss of consumption characterises the decline in economic output in the USA

The US economy contracted in the second quarter at its most severe contraction since the World War II, as many companies closed and millions of jobs were cut during the pandemic. According to a preliminary estimate, gross domestic product fell by 9.5 percent quarter-on-quarter in the second quarter, after -1.3 percent in the first quarter. The

contraction was determined by a decline in consumer spending, exports and investments. With the gradual lifting of the containment measures, economic activity is picking up again. In May and June, 7.3 million new jobs were created in the USA, which means that about one third of the jobs lost since February have been filled again. Retail sales also rose, and indicators based on company surveys (Purchasing Managers' Index, etc.) continue to rise, providing a positive outlook for the coming months. However, this contrasts with the increase in new infections, which may require renewed containment measures or delay the elimination of existing ones. The risk to economic recovery is therefore considerable.

1.2 Strong GDP growth in China

The recovery is progressing in China despite weak foreign demand. After a 10.0 percent quarter-on-quarter decline in economic output in the first quarter, GDP rose significantly in the second quarter with +11.5 percent. While measures to contain the COVID-19 pandemic are being further eased, high-frequency indicators point to a continued normalisation of activity in the following months. The Purchasing Managers' Index in particular paints a positive picture, although a weakness in export orders is slowing the momentum of the upswing. The Chinese authorities have also created extensive fiscal and monetary incentives to support the economy. Fiscal policy aims to stabilise employment and economic growth through the expansion of unemployment insurance, investments and tax reliefs. It is complemented by a monetary policy aimed at ensuring sufficient liquidity in the banking system.

1.3 Euro area economy contracted sharply in the first half of the year

After a 3.6 percent decline in economic output in the euro area in the first quarter, the downturn accelerated in the second quarter (-12.1 percent; Germany -10.1 percent, Italy -12.4 percent, France -13.8 percent, Spain -18.5 percent).

With the gradual lifting of measures to contain COVID-19 infections, there are now many signs that economic activity is recovering. The decline in GDP due to the COVID-19 pandemic seems to have bottomed out in April 2020. Survey data suggest a recovery in both manufacturing and services since May. Thus, an economic recovery could be imminent in the third quarter.

Short-term labour market indicators improved to some extent after the decline in March and April. The Purchasing Managers' Index for employment rose in July to a level

just below the threshold of 50 points, after reaching 33.4 points in April, its lowest level since records began (May 37.8 points). At present, the index continues to point to a decline in employment, although it is likely to

be moderate. The unemployment rate in the euro area was 7.8 percent in June (+0.1 percentage point compared to May); in February it was 7.2 percent.

2. Austria: GDP drops in the first half of 2020

Economic output in Austria fell by 12.8 percent year-on-year in the second quarter of 2020 and by 10.7 percent quarter-on-quarter (seasonally adjusted, key figure according to Eurostat standard). In the first quarter, economic output had already contracted by 2.8 percent year-on-year (seasonally adjusted -2.4 percent, key figure according to Eurostat standard).

The measures to contain the pandemic, the loss of demand from home and abroad and the gradual opening of wholesale and retail trade and the services sectors between mid-April and the end of May determined the course of economic development. In the sectors of wholesale and retail trade, repair of motor vehicles and motorcycles, transportation and storage, accommodation and food service activities, value added fell by a total of 27.8 percent compared with the previous year. At -5.4 percentage points, these sectors accounted for almost half of the GDP decline in the second quarter. The sectors including sports and recreation, arts and entertainment as well as personal services also recorded a 32 percent decline in value added compared to the previous year, although the negative contribution to growth of -0.8 percentage points was moderate due to their low weight. Value added in industry (mining, manufacturing, energy and water supply, waste management) also collapsed (-20.9 percent year-on-year). Concerning construction, a decline of 9.2 percent was recorded. On the other hand, information and communication, financial and insurance activities, real estate and public administration sectors proved to be resistant to the crisis.

The slump affected the demand side of GDP on a broad basis. While the 15.9 percent drop in private consumption (including non-profit institutions serving households) due to restrictions in trade and services significantly dampened economic growth (-8.3 percentage points), investment and export activities were also significantly restricted. Fixed capital formation fell by 10.9 percent and exports by 18.1 percent in the second quarter – the slump in travel exports depressed development here. Imports were 15.3 percent below the level of the previous year. Net exports were thus clearly negative.

2.1 Leading indicators improving – overall assessment remains pessimistic

The index of assessments of the current situation for the overall economy from the WIFO-

Konjunkturtest (business cycle survey) was – after the increase in July – only slightly above the trough during the global financial and economic crisis of 2008-09. An improvement was recorded in all sectors. In the services sectors, the index of the current situation remained close to its historic lows, whereas it was already positive in construction. It also rose in the manufacturing sector, but remained clearly in the pessimistic range.

Business expectations improved in almost all sectors. However, the index for the whole economy remained negative in July. Only in the construction sector it reached positive territory, but remained slightly below the June figure.

The UniCredit Bank Austria Purchasing Managers' Index paints a much more optimistic picture overall. After its low in April, it improved significantly and, at 52.8 points in July, the highest value in one and a half years, it exceeded the 50 point mark, which signals an expansion of the industry, for the first time since the beginning of the COVID-19 crisis. The index performance was essentially shaped by two sub-indicators: output and new orders. Both rose sharply in July. In contrast, the employment outlook remained negative.

2.2 Labour market severely affected by the consequences of the COVID-19 pandemic

The slump in economic output is leaving considerable marks on the labour market. According to preliminary estimates, the number of persons in active dependent employment in July was 88,000 lower than in the previous year (-2.3 percent). Seasonally adjusted, it increased compared to the previous month.

The number of unemployed registered with the Public Employment Service Austria (AMS) was 112,200 higher in July than in the previous year (+41.3 percent), including persons in training 107,300 (+33.3 percent). Seasonally adjusted, the number of unemployed decreased compared to the previous month. The seasonally adjusted unemployment rate according to the national definition was thus 10.7 percent in July according to a preliminary estimate. In comparison with the previous year the increase amounted to 2.7 percentage points.

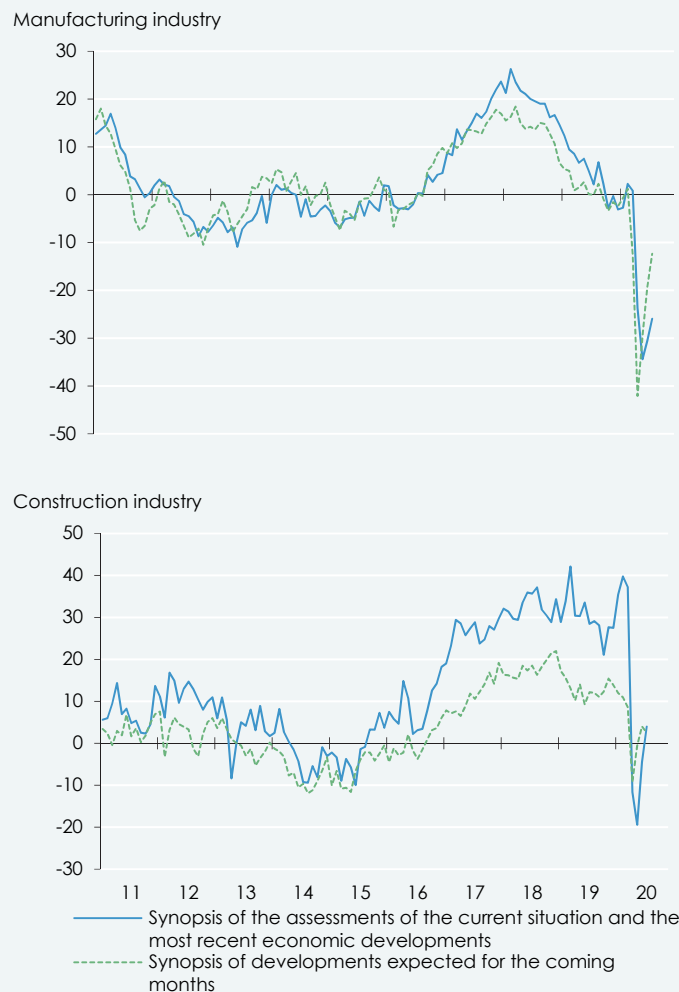
The supply restrictions and the drop in demand led to a slump in economic output in Austria in the first half of the year.

Business surveys have improved in recent months. Expectation indicators in particular have shaped this picture. The current situation, on the other hand, is still viewed very pessimistically.

Although the situation on the labour market continued to improve in July, it remains precarious overall. The unemployment rate remains high.

Figure 2: **Results from the WIFO-Konjunkturtest (business cycle survey)**

Indices of the assessment of the current economic situation and of business expectations, seasonally adjusted



Source: WIFO-Konjunkturtest. Data refer to index points (percentage points) between +100 and -100. Values above 0 imply positive expectations, values below 0 indicate negative expectations.

Inflation accelerated in June. In particular, food and non-alcoholic beverages became more expensive.

2.3 Inflation accelerating recently

Inflation rose from +0.7 percent in May to +1.1 percent in June 2020. In particular, food and non-alcoholic beverages became more expensive (+2.9 percent). The transport sector had a price dampening effect, above all due to the recent, albeit somewhat slower, decline in fuel prices (-18.2 percent). In the category "housing, water, energy", prices rose by an average of 2.3 percent compared to the previous year. Prices in restaurants and hotels rose by an average of 3.0 percent, almost exclusively due to an increase in the price of catering services. Accommodation services were 0.5 percent more expensive than in the previous year.

Higher prices of food and catering services were the main price drivers in June 2020 compared to the previous month, prices of clothing were the main price dampening factors.

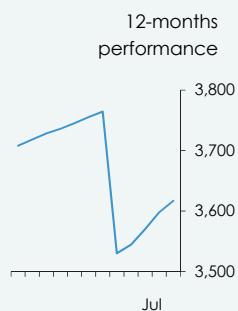
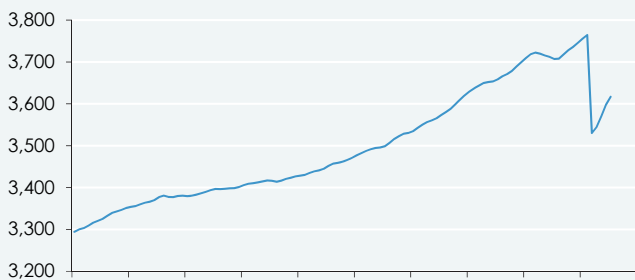
2.4 Tourism significantly affected in June

In Austria, tourism got off to a slow start with the reopening of accommodation facilities. According to provisional results of Statistics Austria, the number of overnight stays in June was probably down by almost 60 percent compared with the previous year at around 5.2 million.

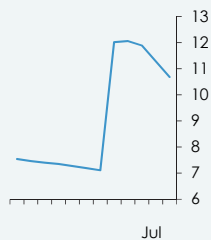
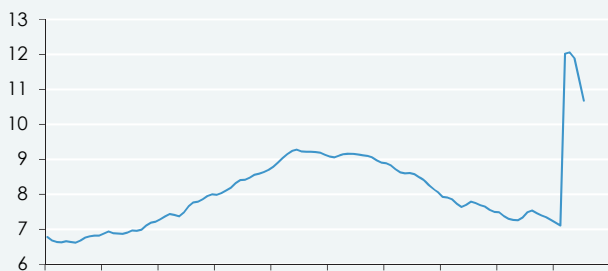
The decline in overnight stays was characterised by a drop in demand from abroad (-73.8 percent) and the domestic market. Guests from Austria accounted for 56 percent of overnight stays. Demand fell sharply on all foreign markets of origin: overnight stays by Germans fell by 65.0 percent, those by guests from Switzerland and Liechtenstein by 66.6 percent and those by travellers from the Netherlands by 86.3 percent. A drop in overnight stays of more than 90 percent was recorded for the markets of origin France, the UK, USA, Denmark, Russia and Sweden.

Figure 3: **Key economic indicators**

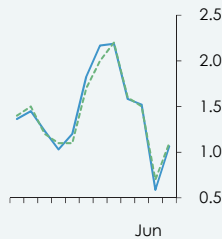
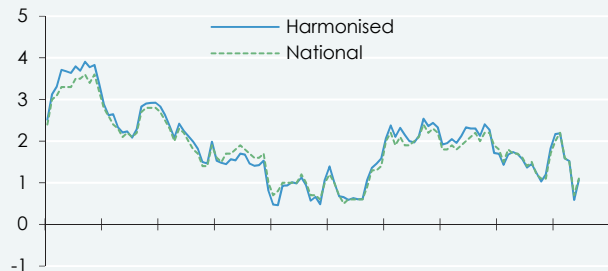
Persons in active dependent employment¹, 1,000s, seasonally adjusted



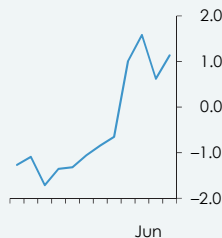
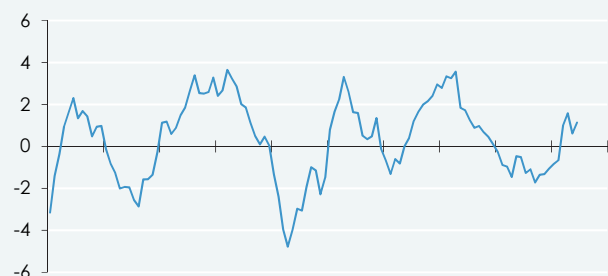
Unemployment rate, traditional Austrian method², seasonally adjusted



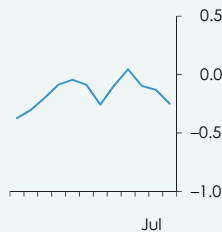
Consumer prices, year-to-year percentage changes



Real effective exchange rate, year-to-year percentage changes



10-year central government bonds (benchmark), percent



Source: Public Employment Service Austria, Federation of Social Security Institutions, Oesterreichische Nationalbank, Statistics Austria, WIFO calculations. – ¹ Excluding persons in valid employment contract receiving child care benefit or being in military service. – ² As a percentage of total labour force excluding self-employed, according to Public Employment Service.

All types of accommodation were affected by the drop in demand. Overnight stays fell most sharply in hotels in the 5/4 star category (-63.6 percent), followed by the 3 star category (-62.4 percent) and 2/1 star hotels

(-61.9 percent). The relatively smallest decline was recorded in private accommodation (-42.8 percent). Overnight stays fell most in Vienna (-87.9 percent) and least in Burgenland (-34.6 percent).