

Sluggish Economic Recovery: Unemployment Threatens to Solidify

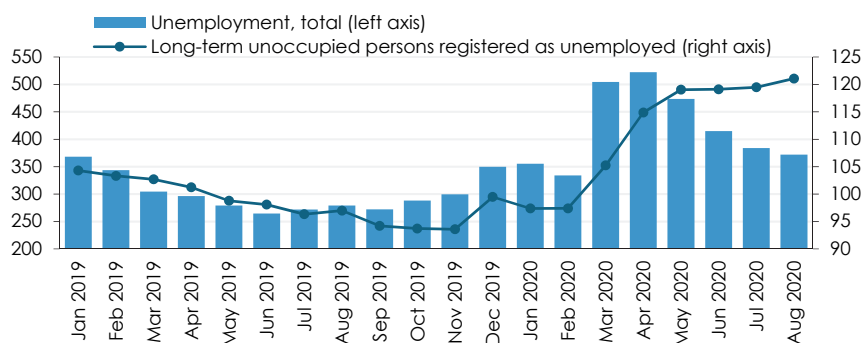
Business Cycle Report of September 2020

Stefan Schiman

- The US Federal Reserve is softening its monetary policy objectives.
- In the large EU countries, all demand components of GDP fell in the second quarter, but to very different degrees.
- In Austria, economic output in the second quarter was one eighth lower than in the previous year.
- The economic climate improved further recently, but credit conditions for companies became more restrictive.
- The relatively stable demand from Germany and an increase in the number of domestic guests prevented an even sharper decline in tourism in July.
- Prices in the accommodation sector are stagnating, while in the restaurant sector they are rising rapidly again.
- In contrast to overall unemployment, the number of long-term unemployed continued to rise in August compared with the previous months and was already close to its previous peak.

Solidification of unemployment

Persons, in 1,000



Since the outbreak of the COVID-19 crisis, the number of long-term unoccupied persons registered as unemployed has been rising steadily, while overall unemployment is already declining again from its peak in April 2020 (Source: Public Employment Service Austria – AMS; long-term unoccupied: within 14 months at least 12 months registered with AMS as unemployed, looking for an apprenticeship, in training etc., and unemployed at the cut-off date).

"So far, only about one-third of the unemployment caused by the crisis has been redressed. As a result, it is consolidating, and long-term unemployment has markedly increased since spring 2020. This development is alarming, especially as the number of long-term unoccupied persons registered as unemployed is already close to its peak of 2016 and the crisis has not yet been overcome."

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In the EU, all components of demand were impacted by the economic downturn in the second quarter; in the UK, France and Italy, private consumption was affected to an above-average extent. In Austria, economic output in the second quarter was one eighth down compared to the previous year's level, the decline thus being less pronounced than the EU average. Tourism suffered less than in Italy or Spain; the development of overnight stays by German and domestic visitors cushioned the drop in demand in July. Only a good third of the unemployment caused by the crisis has so far been recuperated. As a result, long-term unemployment has continued to rise recently.

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The US Federal Reserve realigns its monetary policy objectives. The inflation target of 2 percent is no longer seen as an upper limit, but as an average value, so that values above 2 percent are permissible after a period of below-average inflation. Unlike the ECB, the Fed is also pursuing an employment target. In the future, this will become more prominent than the inflation target if unemployment rises; it will therefore be interpreted asymmetrically.

After the publication of GDP figures in August documented the severe economic slump in the EU countries in the second quarter, the details now show that it affected all demand components. Only in Germany and Spain the negative trend was moderated somewhat by public consumption demand. In Spain and Italy, exports of services suffered a particularly harsh slump due to the substantial importance of tourism, while private consumption fell disproportionately in the UK, France and Italy.

In Austria, the extent and composition of the GDP decline in the second quarter was

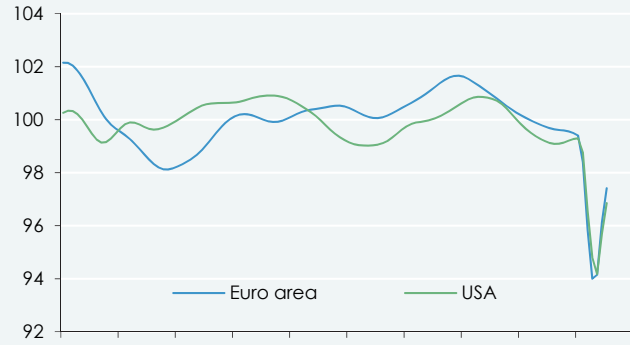
similar to that in Germany. Economic output fell by one-eighth compared with the previous year, while private consumption and gross investments contracted at a slightly higher rate. Public consumption had a stabilising effect, whereas exports contracted by almost one fifth. In contrast to Germany (business expectations according to the Ifo Business Climate Index), the indicator of companies' business expectations in Austria did not increase further in August. The business climate that reflects both expectations and the current situation improved, however. Yet more companies reported a deterioration in credit conditions.

The number of overnight stays in July remained 17.4 percent below the previous year's figure. The decline in summer tourism was cushioned by the only slight decline in demand from Germany (-4.3 percent) and the strong expansion in overnight stays by domestic guests (+15.2 percent). The absence of other international visitors mainly affected city tourism; Vienna recorded nearly three quarters fewer overnight stays than in the previous year.

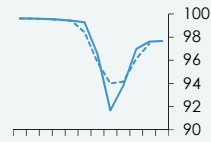
Figure 1: **International Business Climate**

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

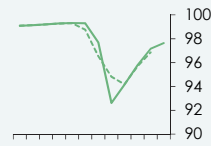
Leading indicators – amplitude



12-month performance

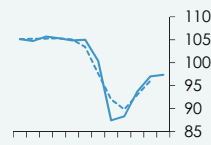


Aug

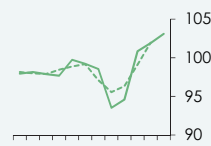


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USA

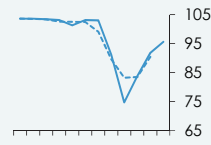
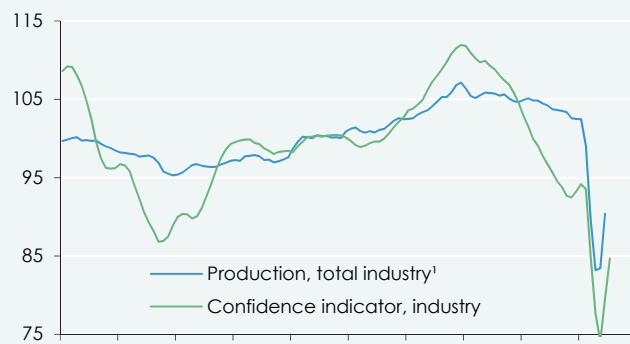


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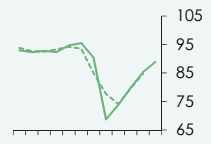


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Euro area

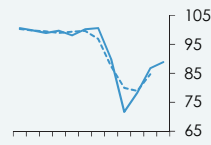
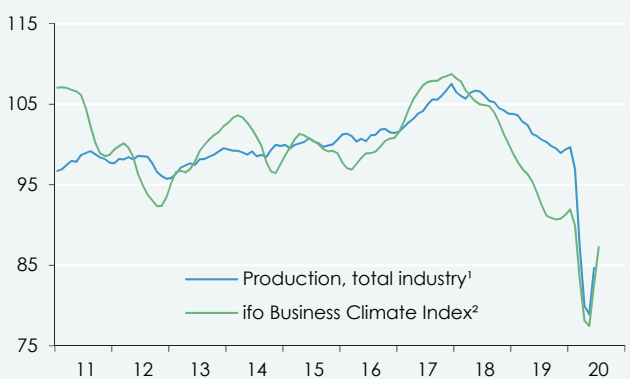


Jul

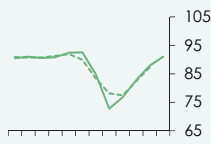


Aug

Germany



Jul



Aug

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

In line with the drop in demand, prices for accommodation stagnated in July after having risen in recent years. In the catering segment, by contrast, prices rose briskly again. Moreover, housing and food also contributed to the overall price increase of 1.7 percent in July.

The reduction of unemployment continued in August. So far, a good third of the crisis-

related surge has been made up for. Due to unemployment declining only slowly, there is a growing risk of solidification. Since spring, the number of long-term unoccupied persons registered as unemployed has been rising. In August, it was already a quarter higher than in the previous year and, at 121,100, almost reached its high from 2016.

1. Fed adjusts inflation and employment targets

In his keynote address at the virtual Jackson Hole symposium, Jerome Powell, chairman of the US Federal Reserve, explained the most important changes to the longer-term goals and monetary policy strategy after an 18-month review.

The Fed is now pursuing an "average inflation target", under which the inflation rate can be above the 2 percent target for a certain period of time in order to compensate for the fact that it has fallen short of the 2 percent target over the last ten years. Previously, a past failure to meet the inflation target was ignored. This "opportunistic inflation strategy" is diametrically opposed to the "opportunistic disinflation strategy" pursued by Alan Greenspan (Fed Chairman 1987-2006), which was intended to reduce the then stubbornly high inflation.

In addition to the average inflation target, an asymmetrical employment target is now being pursued: when unemployment is high, the inflation target takes a back seat to the employment target. Most recently, the unemployment rate in the USA fell relatively sharply from 10.2 percent in July to 8.4 percent in August.

The changes in the employment and inflation targets confirm the extremely expansive strategy that the Fed was already pursuing before the COVID-19 crisis broke out. The existing monetary policy instruments (quantitative easing, forward guidance, emergency facilities) are likely to be used to achieve the revised targets, but the introduction of new instruments was not mentioned.

2. Economic downturn to date varies in the EU countries

In Germany, economic output in the second quarter of 2020 was 11.3 percent lower than in the previous year. The drastic losses affected all areas except the public sector, which had a stabilising effect (+3.8 percent year-on-year). Investments in equipment (-27.9 percent) and exports (-22.2 percent) contracted most sharply, with exports of goods and services declining equally. Private consumption fell by 13.0 percent, while construction investments were hardly affected by the crisis (+1.4 percent).

In France, the loss of value added was not only higher in the private sector than in Germany; public consumption was also severely restricted (second quarter -12.1 percent year-on-year). Investment in machinery and equipment and exports of goods each fell by almost a third (-27.7 percent and -31.9 percent respectively), while exports of services fell by 26.6 percent. Moreover, in contrast to Germany, construction investments in France fell considerably (-26.2 percent). Private consumption was cut back by 16.6 percent. Overall, GDP shrank by 19.2 percent compared with the previous year.

The downturn in GDP in the second quarter was somewhat less severe in Italy (-18.0 percent). However, the country was particularly

affected by the decline in summer tourism, with exports of services shrinking by more than half compared with the previous year (-53.8 percent). Investment in machinery and equipment fell by 29.9 percent, exports of goods by 27.8 percent and construction investment by 23.4 percent. Private consumption fell by 17.6 percent and public consumption by only 2.4 percent.

In Spain, GDP shrank even more sharply than in France in the second quarter of 2020 (-22.1 percent year-on-year), even though public consumption grew by 3.4 percent, similar to Germany. Spain suffered even more from the loss of tourism than Italy, with exports of services 60.9 percent down on the previous year. Moreover, private consumption (-24.5 percent) declined more sharply than in Germany, France or Italy. Investments in machinery and equipment fell by 32.7 percent, construction investments by 30.2 percent and exports of goods by 27.1 percent.

The UK reported a similarly massive slump as Spain in the second quarter (-22.8 percent), with private consumption also contracting by around one quarter (-26 percent). Moreover, the public sector reduced its consumer demand by 17.4 percent. Construction investment was 40.9 percent lower than in the

In the UK and Spain, GDP fell twice as sharply in the second quarter as in Germany.

previous year, investment in machinery and equipment 38.5 percent and exports of services 25.8 percent lower. The decline in exports of goods was comparatively small

(–5.6 percent). This was due to gold exports: London, as an important trans-shipment centre, benefitted from the strong growth in global demand for gold.

3. Austria: GDP in the second quarter one eighth lower than in the previous year

According to current calculations, domestic economic output in the second quarter of 2020 was 12.5 percent down on the previous year's level. Consumer spending by private households was particularly affected. Due to restrictions in the retail and service sectors, they declined year-on-year by 15.4 percent. By contrast, public consumption had a stabilising effect.

Investment activities were also severely restricted, with both investment in machinery and equipment (–18.3 percent) and investment in construction (–10.9 percent). Moreover, as a result of the global economic downturn, exports were one fifth lower than in the previous year (–19.8 percent). Exports of services (–26.5 percent) contracted more sharply than exports of goods (–17.2 percent) due to the massive slump in travel exports.

On the supply side, the service sectors developed unevenly, with a massive drop in value added, especially in the consumption-related industries. In the areas of trade, maintenance and repair of motor vehicles, transportation, accommodation and catering, the decline was –26.7 percent compared to the previous year. The areas of sports, cultural and entertainment facilities and personal services were also significantly affected by the measures to contain the COVID-19 pandemic (value added –32 percent). The information and communication, credit and insurance, real estate and housing sectors cushioned the economic downturn in the second quarter.

3.1 Economic climate continues to recover in August

Despite a further improvement in their economic assessment in August, companies in Austria remained sceptical. Although the WIFO economic climate index (seasonally adjusted) rose by 4.3 points, it was still clearly in negative territory at –10.7 points. While the assessment of the current situation improved further in August, the positive momentum of expectations for the coming months weakened again.

The situation indices improved in all sectors. In the service and industrial sectors, negative assessments still dominate, while the construction industry is once again clearly optimistic. The deterioration in future assessments compared with the previous month

affected all sectors, but the construction industry is slightly optimistic about the future.

3.2 Worsening credit conditions for companies

The majority of companies reported restrictive credit conditions in the quarterly survey conducted as part of the August WIFO-Konjunkturtest (business cycle surveys). At –6.2 points, the credit hurdle – defined as the balance of the share of companies that describe bank lending as accommodating (positive values) and the share of companies that describe it as restrictive (negative values) – was negative for the first time since November 2017 (–6.5 points compared to the previous quarter). Small and medium-sized enterprises in particular are finding it increasingly difficult to obtain credit.

Despite a decline (–3 percentage points compared to the previous quarter), the demand for credit as a result of the COVID-19 crisis is still above average, especially in the sectors that were more severely affected by the crisis. Around 25.4 percent of the companies surveyed reported that they needed credit. About 59 percent of them received the loan as expected. Around 22 percent had to make concessions in terms of the amount of credit or the conditions; this figure was above the average of the past years (18 percent). In addition, 18 percent of the companies with credit needs did not receive a loan because the bank rejected it, the conditions were not acceptable to the companies or they had not applied for a loan in the first place.

3.3 Domestic and German demand supports summer tourism

July 2020 was marked by a significant increase in domestic travel by Austrians, with the number of overnight stays 15.2 percent higher than in July 2019, but overall it fell by 17.4 percent as international demand continued to decline sharply due to the pandemic.

Due to restrictions on air travel and travel bans, guests from overseas stayed away almost entirely (overnight stays by travellers from China around –99 percent, Japan –97 percent, India –96 percent, Russia –95 percent, USA –94 percent). Demand from important European source markets also declined sharply (UK –90 percent, Spain –87 percent, Italy –66 percent,

Private consumption, investments and foreign trade collapsed in Austria in the second quarter, with a massive decline in value added, especially in the consumer-related sectors. Public consumption had a stabilising effect.

Small and medium-sized enterprises in particular find it more difficult to obtain a loan.

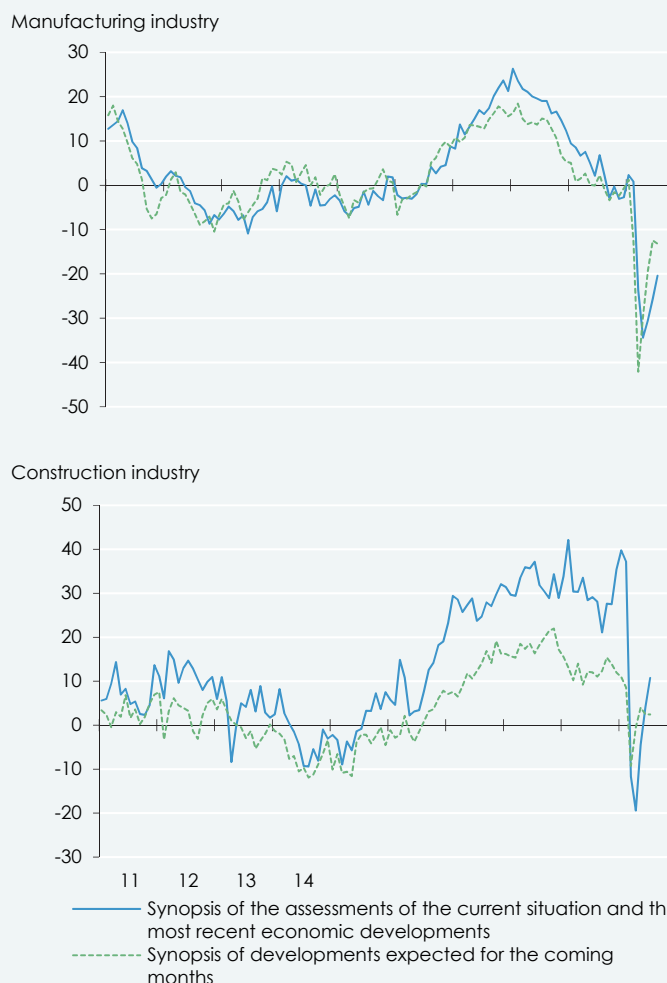
Tourism demand from Germany in July was only 4.3 percent lower than in the previous year (overnight stays totalling –17.4 percent). Domestic travellers spent 15 percent more nights in Austria.

France –56 percent). City tourism in particular suffered from this; in Vienna, overnight

demand in July was almost three quarters lower than in the previous year.

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.

The important segment of German guests (–4.3 percent), which accounts for two-thirds of all international overnight stays, recorded only slight losses in July. Austria probably also benefitted as a replacement destination for traditional vacation destinations such as Italy or Spain. The demand for overnight stays from Switzerland fell by around 7 percent in July, from the Netherlands by almost 22 percent and from Slovakia, the Czech Republic and Hungary by a total of around 34 percent.

3.4 Restaurant prices are rising sharply and prices in the hotel sector stagnate

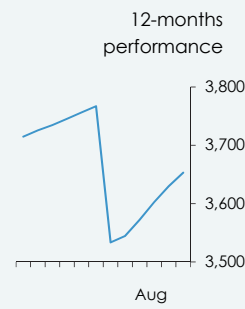
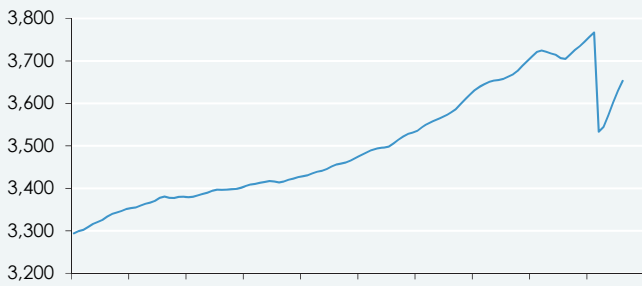
Consumer prices rose by 1.7 percent in July. Prices in the restaurant and catering sector

rose sharply again (catering services +3.7 percent). Following a slowdown to below 3 percent in May, inflation in this sector accelerated again, indicating a recovery in value added. By contrast, prices in the hotel sector (accommodation services), which had always generated strong price increases before the COVID-19 crisis, were still virtually stagnant.

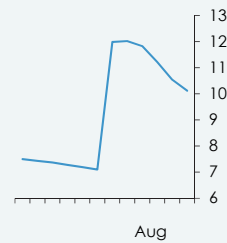
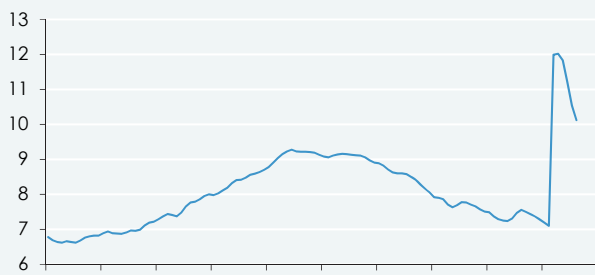
Housing again proved to be a price driver in July (maintenance and repair of the dwelling +3.1 percent, paid rents +4.1 percent), as did food (+2.6 percent). Together, the sectors "housing, water, energy", "restaurants and hotels" and "food and non-alcoholic beverages" contributed about 70 percent to the overall inflation rate in July.

Figure 3: **Key economic indicators**

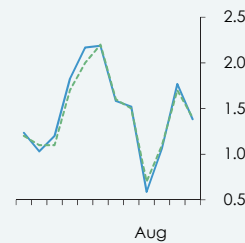
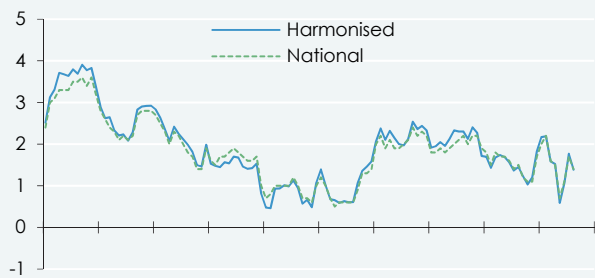
Persons in active dependent employment¹, 1,000s, seasonally adjusted



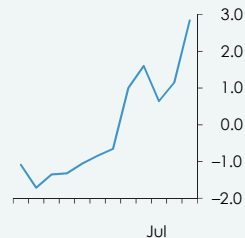
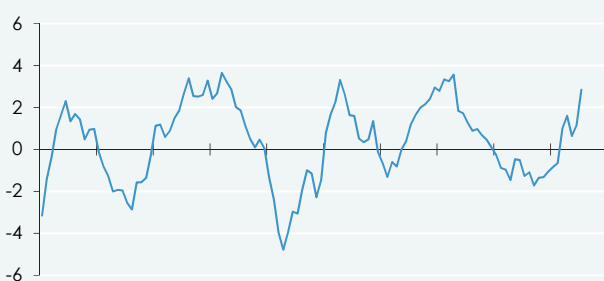
Unemployment rate, traditional Austrian method², seasonally adjusted



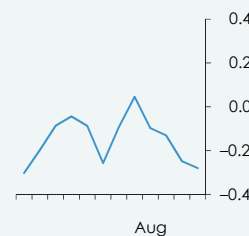
Consumer prices, year-to-year percentage changes



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.

By August, 37 percent of the increase in unemployment caused by the crisis had been offset. Therefore, the risk of unemployment becoming entrenched is growing.

3.5 Slow reduction of crisis-related unemployment feeds long-term unemployment

The slump in economic performance is leaving a considerable mark on the labour market. Since then, about 43 percent of the severe job losses of March 2020 (-233,900 or -6.2 percent compared to February 2020) have been made up for. The seasonally adjusted number of employed persons fell from 3.766,900 in February 2020 to 3.533,000 in March and has since risen steadily to 3.634,000 in August (preliminary estimate). The decline in employment compared with February 2020 due to the crisis thus decreased to -133,000 or -3.5 percent in August.

By August, a good third (37 percent) of the increase in unemployment due to the crisis had been offset. After seasonally adjusted

unemployment had soared from 293,400 in February 2020 to 494,300 in April (+68.5 percent), by August it had fallen to 419,700, which was 126,300 or 43 percent higher than in February. The seasonally adjusted unemployment rate, according to national definition and preliminary estimate, was 10.2 percent in August, 3.1 percentage points higher than in February and 1.9 percentage points lower than in April 2020 when unemployment peaked.

Due to the slow reduction, unemployment is becoming increasingly entrenched. After the number of long-term unemployed had tended to fall since 2017, it has risen again rapidly in all Länder in recent months. The Austrian average in August was 121,100, which was a quarter higher than in August of the previous year and only slightly lower than the highest August figure to date of 122,200 in 2016.