2013: Where Will Growth Come From?

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GDP growth in Austria: 0.9%

ECB likely to lower refinancing rate to 0.5%

Where Will Growth in the Euro Zone and the US Come From?

The economic slowdown in the euro zone has begun a year ago already, but the trough appears not to have been reached yet. “Consumption and investment remain dampened due to the debt crisis. Thus growth impulses from abroad are required, especially for export oriented Germany”, says Mildred Hager, senior macroeconomic analyst at Erste Group. US consumption is going to support global economic growth due to the slowly improving housing and labor markets (US GDP 2013: +2%). Especially euro zone exports should benefit from that. Italy, the third largest economy in the euro zone, could emerge from recession in 2013 – provided further reform measures can be implemented. With that a dampening factor for the euro zone will fall away as the year progresses. That should lead to the beginning of a slow recovery in Germany and France. “At present we anticipate economic growth of +0.4% in the euro area in 2013”, Hager says.

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The unemployment rate will continue to increase in the periphery (close to 12% in the euro zone), exerting a dampening effect on inflation. The ECB should therefore implement additional policy measures (among others, a lowering of the refinancing rate to 0.5%). With the announcement of the ECB's bond purchasing program the risk of excessive financing costs for the peripheral countries can be averted – but only as long as their debt burden remains sustainable. A solution to the debt crisis is therefore still not in the offing in 2013. The Fed has recently once again adopted a more expansive monetary policy as well. “The question remains whether and for how long the central banks can continue to support the economy”, Hager says. In view of loose monetary policy and a weak economy, benchmark interest rates (German Bunds, treasuries) should remain low. The somewhat better outlook for the US economy argues for a slightly stronger dollar in the course of the year.

What Does This Mean for Austria and Austrian Government Bonds?
“Austria's economy is broadly diversified and therefore less crisis-prone than those of other nations”, says Gudrun Egger, head of Major Markets and Credit Research at Erste Group. Since 2002 growth is higher than in the euro zone and real GDP per capita is 19% above the euro zone average. This prosperity is supported by Austria's strong international competitiveness. However, the softening in foreign trade currently influences the dynamics of Austria's economy as well, as Austria is an open economy with exports representing a 57% share of GDP (euro zone average: 44%). Especially the recession in the second most important export destination Italy and in parts of Eastern Europe weighs on export growth. A stabilizing effect is however provided by private consumption, which among other things is benefiting from a low unemployment rate. “Assuming a slow global recovery, we expect growth of +1% in Austria this year, exceeding the euro zone average”, Egger says. In 2014 even +1.7% growth is expected to be seen again.

Internationally, Austria enjoys a reputation as a safe haven and is rated at the top “triple A” rating by three of the four most important credit rating agencies. Above average economic growth and long term fiscal discipline have helped to keep the public debt at a moderate level of 75% of GDP. In view of the fundamental backdrop (low growth) investors continue to look for high quality investment assets. The shrinking universe of “safe assets” should contribute to keeping the yields of high quality bonds at a low level. “As the spread to Germany has tightened considerably last year from 115 basis points in January to 40 basis points in December, we see the potential for further tightening as limited, however, a level of 25 to 30 basis points can definitely be attained”, says Egger. In conclusion, yields on Austrian government bonds are expected to remain low.