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Crisis in the Euro Area Delays Cyclical Upturn in Austria

Economic Outlook for 2013 and 2014

The recovery in the euro area suggested by several leading indicators early this year has so far not set in. Hence, demand and output in Austria disappointed in the first quarter of 2013. For the second half of the year, WIFO expects a gradual pick-up, leaving GDP growth for the whole year at a modest 0.4 percent, before strengthening to a rate of +1.6 percent in 2014.

For definitions of terms used, see "Methodological Notes and Short Glossary", in this volume and http://www.wifo.ac.at/wwadocs/form/WIFO-BusinessCycleInformation-Glossary.pdf • All staff members of the Austrian Institute of Economic Research contribute to the Economic Outlook. Data processing: Nora Popp • Cut-off date: 26 June 2013. • E-mail address: Stefan.Schiman@wifo.ac.at

While the business cycle recovery keeps progressing in the USA, Japan and parts of South-East Asia, South America and Africa, activity remains sluggish in Europe and in particular in the euro area. Several countries in the European periphery have taken measures to boost price competitiveness and lower the external deficit. Yet, due to the low export ratios of the countries concerned and the subdued growth of world trade[1], the negative repercussions of these measures for the domestic economy prevailed. Given banks' reservation in granting new credit, shortfalls of internal financing can in many instances not be compensated by external borrowing. At the same time, the restraint in government demand in many countries is heavily weighing on growth.

In Austria, the momentum of exports and investment keeps being muted by the weak international environment. The limited real income gains and increased saving by private households constitute a drag on consumer demand. Real GDP is expected to edge up by only 0.4 percent in 2013. Employment growth is losing pace (2013 +0.7 percent, 2014 +0.8 percent), while the unemployment rate moves up to 7.5 percent and 7.6 percent, respectively. Inflation is gradually abating to 2.2 percent on annual average 2013 and 2.0 percent in 2014.

World trade usually grows swiftly with solid output growth (recorded at +3.2 percent in 2012 for the global economy; average 1992-2012 +3.6 percent); thus, it is expected to revert to its long-term trend increase of 6.0 percent by 2014. As a strong export performer, the Austrian economy stands to benefit from this revival: export growth should thus accelerate in 2014 and provide stimulus to domestic private investment. Private households are expected to use a larger part of their income gains in 2014 for consumption. In all, real GDP growth is projected to pick up to an annual 1.6 percent in 2014.

[1] World trade increased by 1.9 percent in 2012 (average 1992-2012 +6.0 percent) and hence significantly less than global output (+3.2 percent). According to the OECD, a lower-than-output increase of world trade has been observed only six times over the last 50 years (most recently during the cyclical downturns of 2001 and 2009).

Table 1: Main results

		2009	2010	2011	2012	2013	2014
		Percentage changes from previous year					
GDP							
Volume		– 3.8	+ 2.1	+ 2.7	+ 0.8	+ 0.4	+ 1.6
Value		– 2.3	+ 3.7	+ 5.0	+ 3.4	+ 2.5	+ 3.5
Manufacturing[1], volume		– 12.7	+ 7.0	+ 8.2	+ 1.1	+ 1.0	+ 3.5
Wholesale and retail trade, volume		– 0.3	+ 1.4	+ 1.3	– 1.4	– 0.8	+ 1.3
Private consumption expenditure, volume		+ 1.1	+ 1.7	+ 0.7	+ 0.4	+ 0.2	+ 0.9
Gross fixed investment, volume		– 7.8	+ 0.8	+ 7.3	+ 1.2	+ 1.0	+ 1.5
Machinery and equipment		– 10.6	+ 6.0	+ 12.1	+ 0.3	+ 1.5	+ 2.0
Construction		– 7.1	– 2.7	+ 4.4	+ 1.2	+ 0.5	+ 1.1
Exports of goods[2]							
Volume		– 18.3	+ 13.0	+ 7.9	+ 0.2	+ 1.8	+ 5.5
Value		– 20.2	+ 16.7	+ 11.3	+ 1.4	+ 2.0	+ 6.6
Imports of goods[2]							
Volume		– 14.1	+ 10.9	+ 8.5	– 0.4	+ 0.8	+ 5.2
Value		– 18.4	+ 16.5	+ 15.3	+ 0.7	+ 0.8	+ 6.0
Current balance	billion €	+ 7.49	+ 9.74	+ 4.08	+ 5.47	+ 7.91	+ 9.19
As a percentage of GDP		+ 2.7	+ 3.4	+ 1.4	+ 1.8	+ 2.5	+ 2.8
Long-term interest rate[3]	percent	3.9	3.2	3.3	2.4	1.8	1.8
Consumer prices		+ 0.5	+ 1.9	+ 3.3	+ 2.4	+ 2.2	+ 2.0
Unemployment rate							
Eurostat definition[4]	percent	4.8	4.4	4.2	4.3	5.0	5.1
National definition[5]	percent	7.2	6.9	6.7	7.0	7.5	7.6
Persons in active dependent employment[6]		– 1.5	+ 0.8	+ 1.9	+ 1.4	+ 0.7	+ 0.8
General government financial balance according to Maastricht definition							
As a percentage of GDP		– 4.1	– 4.5	– 2.5	– 2.5	– 2.3	– 1.7

Source: WIFO. 2013, 2014: forecast. – [1] Value added, including mining and quarrying. – [2] According to Statistics Austria. – [3] 10-year central government bonds (benchmark). – [4] According to Eurostat Labour Force Survey. – [5] According to Public Employment Service Austria, as a percentage of total labour force excluding self employed. – [6] Excluding parental leave, military service.

Steady cyclical recovery in the USA

Private consumption is supporting business activity in the USA. Monetary expansion and higher asset values prevail over the dampening impact of fiscal policy.

Consumer confidence in the USA is following a moderate upward trend. The monetary measures of the Central Bank are creating favourable financing conditions. Construction is expanding and rising real estate prices boost private household wealth. Five years after the onset of the financial market crisis, debt burdens have eased, even if to a large part by private insolvency. The latest cuts in government spending have not yet dented private consumption. Towards the end of 2012, investment has been temporarily lifted by preemptive spending before the expiry of tax subsidies; energy-intensive projects may benefit from relatively low energy prices (for crude oil and shale gas). The recovery is held back by the automatic budgetary cuts of the "sequester" that took effect in March 2013 and may hurt certain cyclically-sensitive items like infrastructure spending. GDP is expected to grow by 1.8 percent in 2013 and 2.4 percent in 2014.

Tide change in China

The slowdown in Chinese growth is partly caused by structural factors. Strong credit expansion in the parallel banking sector carries certain risks for financial market stability.

GDP in China has recently been growing below expectations. Two trends are reinforcing each other: first, private consumption has since 2011 consistently provided larger growth contributions than investment; second, contributions to GDP growth from services have since mid-2012 exceeded those from industrial output. Thus, the slowdown is to some extent the consequence of a structural shift in China towards a service economy. The assumption of China facing a diminishing growth potential rather than an entirely cyclical "soft patch" is confirmed by the unemployed/vacancy ratio which, according to Nomura Bank, has fallen to its lowest reading since 2001. Yet, the Chinese economy is only about to enter this transformation process, with major challenges still ahead. Overall, there is still a substantial overhang of saving and investment over consumption. Moreover, local communities have taken on sizeable amounts of debt over the last years in order to support business activity. Together with the expansion of parallel banking institutions that is fuelled by the tight regulation of the official financial sector, there are major risks for the stability of the country's financial markets. GDP is expected to grow by 7.5 percent in 2013 and 8.0 percent in 2014.

Table 2: World economy

	2009	2010	2011	2012	2013	2014
	Percentage changes from previous year					
Real GDP						
World	– 0.6	+ 5.2	+ 4.0	+ 3.2	+ 3.2	+ 3.8
USA	– 3.1	+ 2.4	+ 1.8	+ 2.2	+ 1.8	+ 2.4
Japan	– 5.5	+ 4.7	– 0.6	+ 1.9	+ 1.3	+ 1.8
EU 28	– 4.3	+ 2.1	+ 1.6	– 0.3	– 0.3	+ 1.2
Euro area 17	– 4.4	+ 2.0	+ 1.4	– 0.6	– 0.7	+ 1.0
Germany	– 5.1	+ 4.2	+ 3.0	+ 0.7	+ 0.2	+ 1.8
New EU countries[1]	– 3.2	+ 2.3	+ 3.3	+ 0.8	+ 0.8	+ 2.1
China	+ 9.2	+ 10.4	+ 9.3	+ 7.8	+ 7.5	+ 8.0
World trade, volume	– 12.4	+ 14.5	+ 6.0	+ 1.9	+ 3.2	+ 6.0
Market growth[2]	– 10.9	+ 11.4	+ 6.3	+ 1.6	+ 1.8	+ 5.5
Primary commodity prices						
HWWI index, total	– 34.7	+ 28.9	+ 28.6	– 2.8	– 6	+ 2
Excluding energy	– 28.4	+ 31.9	+ 19.2	– 14.4	– 5	+ 10
Crude oil prices						
Brent, $ per barrel	61.5	79.5	111.3	111.6	105	105
Exchange rate						
$ per euro	1.393	1.327	1.392	1.286	1.30	1.30

Source: WIFO. 2013, 2014: forecast. – [1] Bulgaria, Czech Republic, Hungary, Latvia, Lithuania, Poland, Romania. – [2] Real import growth of trading partners weighted by Austrian export shares.

Reform efforts in Japan

The sustainability of the latest policy measures taken in Japan still needs to be confirmed; business confidence has so far not improved significantly.

The new Japanese government, together with the country's Central Bank, is pursuing a three-pronged strategy to pull the country out of deflation and revive the economy. The first pillar is a sizeable budgetary stimulus, designed to invigorate demand still this year and facilitate fiscal consolidation during 2014. Second, this policy is supported by massive monetary expansion, with money supply to be doubled by 2015. Third, economic efficiency is to be enhanced by structural reform, such as the liberalisation of energy and agricultural markets or the promotion of female employment. Whether reforms will get under way on a sustained basis remains to be seen. Business confidence has hardly improved so far, and there are no signs of an increase in wages which would be a necessary condition for definitively getting rid of deflation. Nevertheless, the signs of the short-term effects are encouraging. As a result of yen depreciation, exports rebounded strongly in the first quarter 2013, and private consumption has firmed. For 2013, real GDP growth is projected at 1.3 percent, accelerating to 1.8 percent in 2014.

Activity in Europe remaining sluggish

Strong and simultaneous restraint of government demand in several EU member countries, rising unemployment, tight bank lending and stagnating world trade all weigh on business activity in the euro area.

In the euro area, a cyclical recovery has so far been absent, as GDP edged down by 0.2 percent in the first quarter 2013. The slight increase in the EU leading indicator at the end of 2012 that arrested the downward trend observed since the beginning of 2011, came to a halt in early 2013; since that time, the indicator has been broadly flat at a level below the longer-term average. An early and lasting recovery is not in sight. In most countries, government demand is having a restrictive impact on economic activity, and the expansionary policy of the ECB does not deploy its full effect. Against the background of high unemployment and the squeeze in private purchasing power, private demand is held back by adverse sales expectations and high interest rates on loans, particularly in the crisis countries. The liberalisation of labour markets may have added to the cyclical downturn. In addition, in a number of countries high private sector indebtedness is weighing on consumption and investment after the burst of the asset bubble.

Positive incentives may only be expected from foreign trade. However, countries with low export ratios like Greece, Spain, Portugal, Italy and France will benefit least from the rebound in global trade. The negative domestic effects from wage cuts and other policy action designed to boost price competitiveness are likely to dominate the expected positive impact of higher exports. These countries are thus likely to remain in recession in the current year. In Cyprus and Slovenia, severe disruptions in the financial sector will cause a lasting contraction of demand and output; the slump in asset values after the burst of a real estate price bubble will lead to a fall of GDP also in the Netherlands. On the other hand, countries with strong export performance like Ireland, Germany, Austria, the Baltic countries, Hungary and Slovakia stand to benefit from the revival of world trade. In all, WIFO expects euro area GDP to shrink by 0.7 percent in 2013, giving way to a modest rebound of 1.0 percent in 2014; for the entire EU, the corresponding GDP projections are –0.3 percent in 2013 and +1.2 percent in 2014.

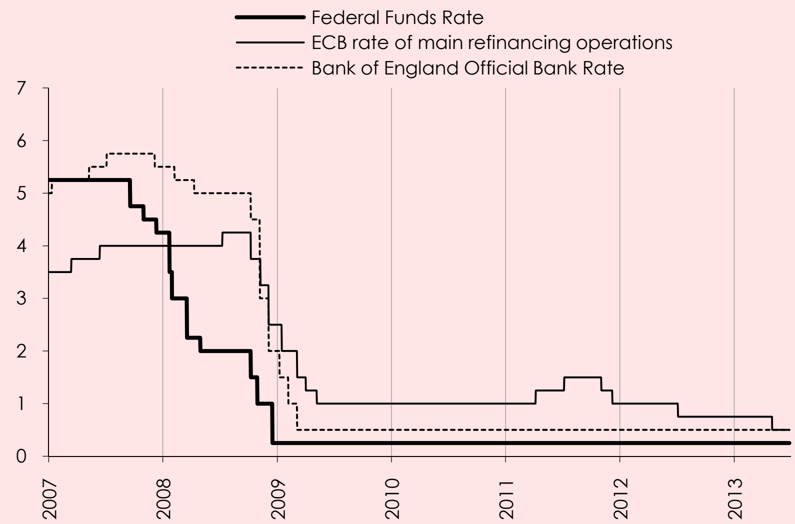
Interest rate cut by ECB with negligible effect

Economic policy at the level of the euro area is in a stand-by mode. The cut in the key interest rate has virtually no expansionary effect, given the impaired credit channels.

On 2 May 2013, the ECB lowered the main refinancing rate from 0.75 percent to 0.50 percent and extended the deadline for unlimited central bank lending until July 2014. Between May 2009 and July 2012, the main refinancing rate stood at 1 percent, with the exception of the period from April to December 2011, when it was temporarily raised up to 1.5 percent. Both in the USA and the UK, key interest rates are lower (0 percent to 0.25 percent and 0.5 percent, respectively) and have been held constant for more than four years.

Figure 1: Key interest rates in the euro area, the UK and the USA

Percent



Source: ECB, Federal Reserve, Bank of England.

If the monetary transmission mechanism is intact, a cut in the key interest rate can be expected to be passed on by the commercial banks to debtors. Financing of durable consumer goods (e.g., motor cars) and investment projects (notably construction works) would become cheaper; at the same time, lower credit rates would facilitate the servicing of existing debt and create scope for new spending. Higher credit demand would lead to higher consumption, investment and employment. Traders of securities, by selling off euro-denominated bonds, would trigger a depreciation of the euro which would facilitate exports to third countries. However, since the interest rate move by the ECB was small (–0.25 percentage point), the effects would have been small even with the transmission mechanism working smoothly:

according to the Oxford Global Economic Model, euro area GDP growth would be raised by a mere 0.1 percentage point in 2014, with the impact on the current account and the unemployment rate being negligible.

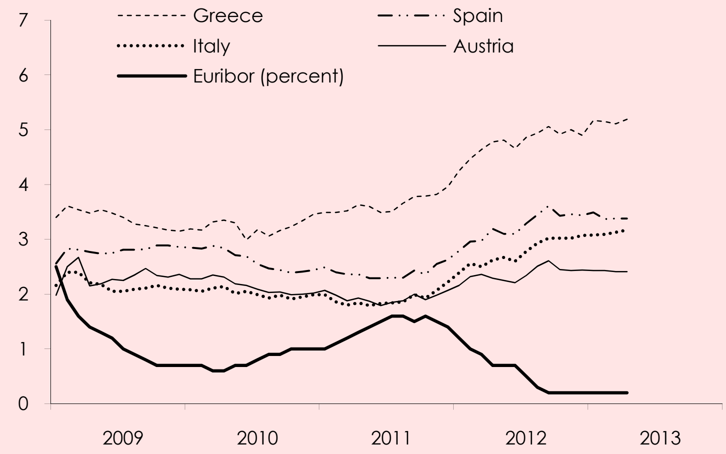
The pass-through of central bank rate cuts to lower commercial credit rates is inhibited by high risk premia, notably for the euro area periphery countries, which counteracts the ECB interest rate policy. Hence, credit rates for companies in Spain, Greece and Italy barely reacted to the rate cuts of end-2011; indeed, as of 2012, a marked increase in the spread vis-à-vis the Euribor can be observed (Figure 2). Consumer credit has even become more expensive in some countries during the last two years. At the same time, credit conditions are becoming more and more favourable in countries like Germany and Austria. A new programme set up by the German business development bank KfW aims at easing the credit squeeze in Spain and Portugal via government-guaranteed loans.

Not only credit supply, but also credit demand is likely to react less than inferred by model simulations, given that the private sector is highly indebted and takes easier financing conditions as an opportunity for earlier deleveraging rather than for new purchases. Sales expectations probably play a key role in this regard: if the assessment of a lasting demand weakness prevails, companies will be induced to keep their liquid assets on bank accounts rather than stepping up spending on fixed capital, despite better financing conditions.

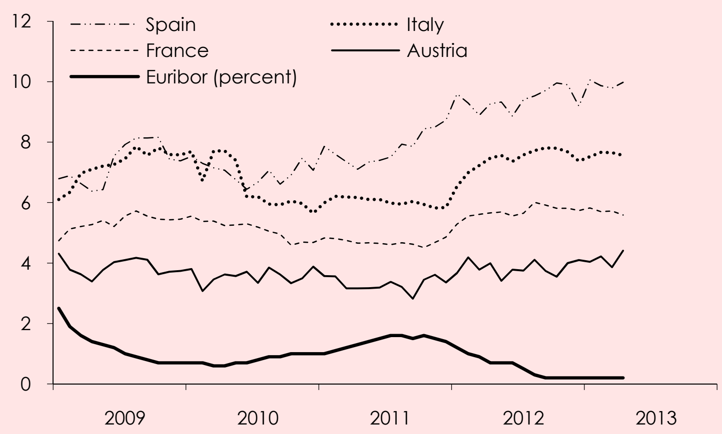
Figure 2: Interest rate spreads in the euro area for credits of 1 to 5 years maturity

Interest rate differential vis-à-vis 3-months Euribor in percentage points

For commercial credit outstanding

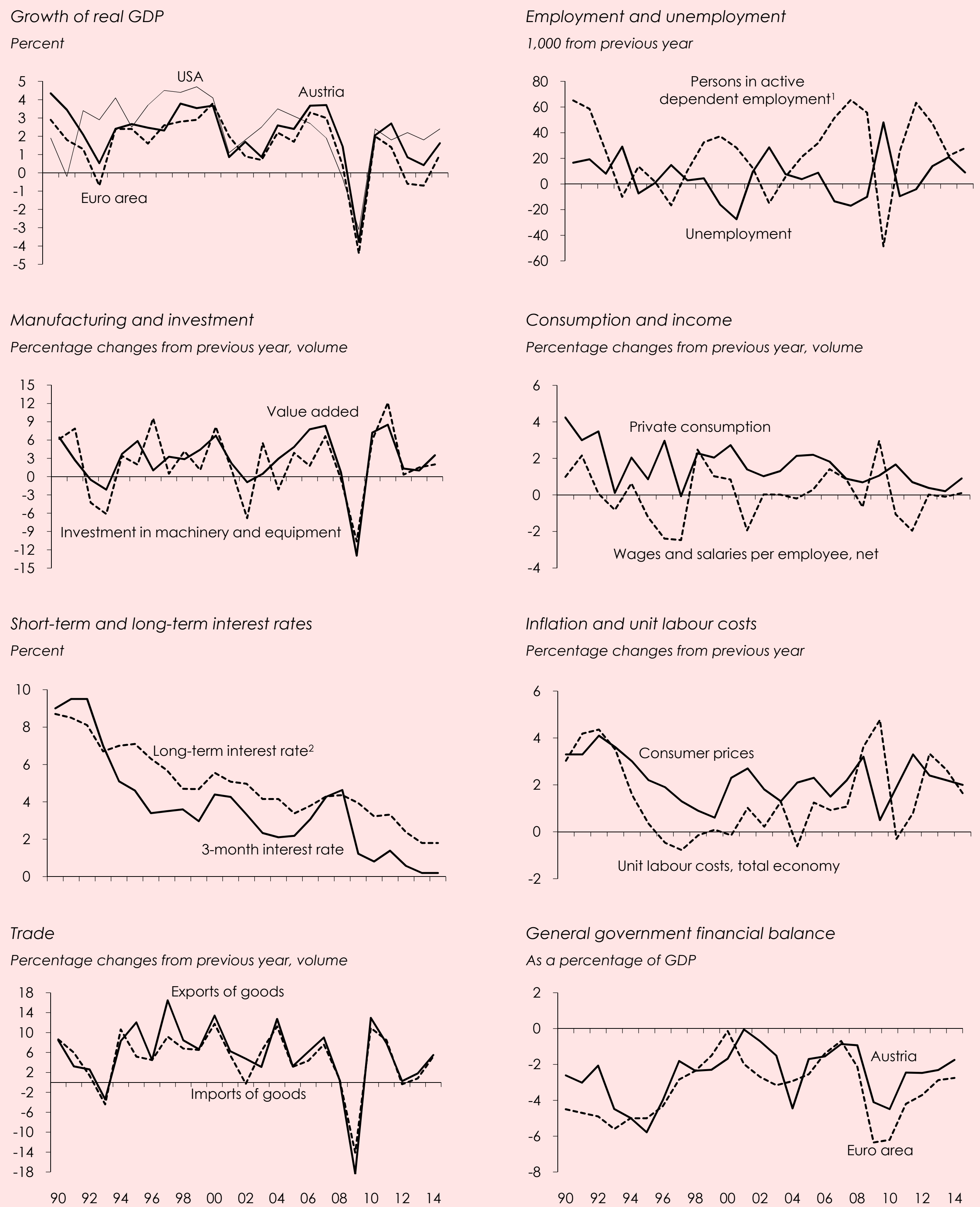


For new consumer credit to private households



Source: ECB.

Figure 3: Indicators of economic performance



Source: WIFO. 2013, 2014: forecast. – [1] Excluding parental leave, military service, and unemployed persons in training. – [2] 10-year central government bonds (benchmark).

While on the part of the ECB there are considerations on how to relaunch commercial bank lending, their early implementation appears unlikely given political reservations in several member countries, particularly in Germany. Most of such non-standard monetary policy measures imply a guarantee by the central bank. The purchase of mortgage-backed securities by the Fed and the "Funding for Lending" programme by the Bank of England have proved more effective than the measures taken by the ECB; by pooling default risks with the central bank, bank lending is to be strengthened, thereby supporting the economic recovery and reducing in turn the risks of default.

Not only monetary policy responded to the persistence of the euro area crisis by introducing certain adjustments, but also fiscal policy: the European Commission has extended the deadlines for meeting budgetary targets for seven countries, i.e., Spain, Portugal, France, Poland, Slovenia, Netherlands and Belgium. Adverse cyclical conditions in these countries are compounded by severe banking problems in Spain and Slovenia, while private households in the Netherlands are hurt by the slump in asset values after the burst of a real estate bubble. The latest policy moves confirm earlier WIFO assumptions of a gradual relaxation of budgetary targets.

Austria: business activity recovers only gradually

The forecast of a cyclical upswing for the Austrian economy is maintained. For the current year, the projection for GDP growth is nevertheless revised down to 0.4 percent, gathering pace to an annual rate of 1.6 percent in 2014.

Sluggish growth in neighbouring countries is complicating the cyclical recovery in Austria. The economy has been stagnating for the last twelve months; foreign trade has slackened markedly already since mid-2011. While volume exports and imports had grown by a seasonally-adjusted 2.3 percent per quarter since early 2010, their pace has slowed to an average 0.3 percent and 0.2 percent respectively. The slowdown has extended to business fixed investment which had gained an average 2.1 percent until mid-2011, but is stagnating since (+0.1 percent). A further retarding factor is the slow advance of private consumption following the squeeze in real incomes in 2010 and 2011. The pick-up of the WIFO Leading Indicator towards the end of 2012 and in early 2013 points to an increase in output as from the middle of 2013. In the most likely scenario retained by WIFO, GDP will expand by 0.4 percent in 2013 and by 1.6 percent in 2014[2].

Foreign trade remaining subdued in 2013

Major Austrian foreign markets are in stagnation or recession. An alleviating factor for the trade balance is the decline in oil prices.

Growth of Austria's exports has recently been driven by the three non-EU members among the ten largest of Austria's foreign markets: the USA, Switzerland and Russia. Deliveries to other EU member countries have been broadly flat; in three of the ten major foreign destinations, GDP receded in 2012 (Italy, Czech Republic, Hungary), while it stagnated in France; growth in Germany and the UK was muted, whereas it decelerated markedly in Poland. Sales prospects remain weak in these countries also for 2013: GDP is expected to fall in Italy, France and the Czech Republic, while it is expected to grow below 1 percent in Germany, the UK, Hungary and Poland. Demand from third countries should cushion the slowdown to some extent. Austria's merchandise exports are projected to expand by only 1.8 percent in volume in 2013, accelerating to 5.5 percent in 2014 with the revival of global trade.

The gradual easing of commodity prices, notably of crude oil is set to continue in 2013, before petering out in 2014. This should alleviate Austria's trade balance which had weakened in the last years under the impact of higher oil prices and the stagnation in the exchange of finished goods. The euro exchange rate against the dollar, influenced by opposing forces, should keep within a range from 1.2 to 1.4 $ per €. Downward risks derive from the growth differential between the two economic zones, while the inflation differential constitutes an upward risk; a neutral element is the low-interest environment in both cases.

Weak external demand dampens business investment

In parallel with the muted outlook for the export sector, responses in the regular WIFO Business Cycle Survey have turned more sceptical. Companies' assessment of current business conditions has become more negative since the beginning of the downturn in mid-2011. The decline is due inter alia to the downward trend in export orders, as firms gradually adjust their judgement to the developments abroad. Ex-

[2] The statistical overhang from 2012 is around –0.1 percent, which has to be made up before growth can be achieved. For 2014, the forecast implies a carry-over of 0.5 percent from 2013. The projected GDP increase in 2014 only would thus contribute 1.1 percentage points to the projected annual growth rate of 1.6 percent.

pectations on incoming export orders for the next three months should have passed their trough, as the downward trend became flatter at the end of 2012. The balance of firms expecting higher export orders over those expressing a negative opinion has markedly improved in the survey of last April from three months earlier, although still remaining below the longer-term average.

While financing conditions for companies remain favourable, investment in machinery and equipment is constrained by the sluggishness of final demand. However, in the construction sector, excess demand is pushing up prices.

Table 3: Productivity

	2009	2010	2011	2012	2013	2014
		Percentage changes from previous year				
Total economy						
Real GDP	− 3.8	+ 2.1	+ 2.7	+ 0.8	+ 0.4	+ 1.6
Employment[1]	− 0.9	+ 0.7	+ 1.8	+ 1.3	+ 0.7	+ 0.9
Productivity (GDP per employment)	− 2.9	+ 1.4	+ 0.9	− 0.4	− 0.3	+ 0.7
Manufacturing						
Production[2]	−13.0	+ 7.2	+ 8.5	+ 1.3	+ 1.0	+ 3.5
Employees[3]	− 5.3	− 1.3	+ 1.9	+ 1.7	+ 0.1	+ 0.1
Productivity per hour	− 4.7	+ 5.4	+ 6.6	+ 0.2	+ 1.4	+ 3.0
Working hours per day per employee[4]	− 3.5	+ 3.0	− 0.1	− 0.6	− 0.5	+ 0.4

Source: WIFO. 2013, 2014: forecast. – [1] Dependent and self-employed according to National Accounts definition. – [2] Value added, volume. – [3] According to Federation of Austrian Social Security Institutions. – [4] According to "Konjunkturerhebung" of Statistics Austria.

The downward trend in business expectations has been arrested at the end of 2011. Employment has increased; the share of firms being constrained in their production by labour shortage has steadily declined in the last two years. Financing conditions have improved further, with interest rates set to remain low up to the forecast horizon: the 3-months rate is projected at an average 0.2 percent, the yield on 10-year federal government bonds outstanding at 1.8 percent. Yet, the low interest rates will hardly stimulate investment which is constrained by the sluggishness of aggregate demand: the share of firms seeing their output limited primarily by lack of demand rose from 12 percent in early 2011 to 20 percent in April 2013. Overall investment in machinery and equipment is projected to rise by only 1.5 percent in 2013 and by 2.0 percent in 2014.

Construction activity lost momentum in late 2012 and early 2013, partly undermined by weather conditions. In the WIFO Business Cycle Survey, opinions on current conditions turned to a negative balance for the first time since the end of 2009. In civil engineering, some projects are being postponed on account of the need for consolidation of public budgets. The number of new residential building permits dropped in 2012, despite the fast-growing need for affordable dwellings, particularly in urban areas, which for demographic reasons promises to stay high in a medium-term perspective. The demand overhang is mirrored by an above-average increase in rent and house prices (2012 +4.4 percent and +12.4 percent, respectively). For the whole year 2013, construction investment is set to edge up by 0.5 percent, picking up to 1.1 percent in 2014.

Moderate income gains and higher private saving weigh on consumption

After a decline in 2010 and 2011, real incomes are set to stay on the moderate upward trend observed in 2012. Part of the gains will be used for higher saving. Job growth will lose momentum, leading to a further increase in unemployment.

Real disposable income of private households diminished in 2010 and 2011, but edged up in 2012. Dissaving by households continued until 2011; since then, the savings ratio is heading up, accompanied by spending restraint. The same pattern is expected for the current year, with private consumption growth projected at a marginal 0.2 percent. On the one hand, real incomes offer little scope for higher outlays (with disposable income projected at +0.4 percent, gross wages per capita +0.2 percent); on the other hand, households will seek to increase their financial reserves a bit further (savings ratio 7.9 percent) in order to offset asset value losses suffered during the crisis. By 2014, the projected income gains (disposable income +0.9 percent, gross wages per capita +0.4 percent), partly driven by easing inflation (headline rate 2013: 2.2 percent, 2014: 2.0 percent), should allow a more substantial increase in private consumption of 0.9 percent.

Rise in unemployment caused by continued growth of labour supply

Employment growth is losing momentum in 2013 (+0.7 percent; 2014 +0.8 percent), affecting to a large extent part-time jobs. Female employment is expanding significantly faster than male employment. The cyclical weakness reduces demand for personnel from temporary employment agencies which is not compensated by hiring on permanent contracts.

In parallel with employment, growth of labour supply is slowing down, albeit less, such that the unemployment rate edges up from 7.5 percent to 7.6 percent in 2014. Labour supply growth is concentrated on women, foreigners and older workers. Foreign workers arrive mainly from the closer neighbourhood which allows them to commute on a daily or weekly basis and benefit from the better job situation in Austria than in their home country (e.g., Hungary).

Table 4: Private consumption, income and prices

	2009	2010	2011	2012	2013	2014
	Percentage changes from previous year					
Private consumption expenditure	+ 1.1	+ 1.7	+ 0.7	+ 0.4	+ 0.2	+ 0.9
Durables	+ 4.8	+ 2.3	+ 1.8	− 4.8	− 4.2	+ 0.8
Non-durables and services	+ 0.6	+ 1.6	+ 0.6	+ 1.0	+ 0.7	+ 0.9
Household disposable income	+ 0.3	− 0.6	− 0.9	+ 0.6	+ 0.4	+ 0.9
	As a percentage of disposable income					
Household saving ratio[1]	11.2	9.1	7.4	7.7	7.9	8.0
Household saving ratio[2]	10.6	8.6	7.1	7.3	7.5	7.6
	Percentage changes from previous year					
Direct lending to domestic non-banks[3]	− 1.3	+ 2.9	+ 2.6	+ 0.0	+ 0.9	+ 2.9
	Percentage changes from previous year					
Inflation rate						
National	0.5	1.9	3.3	2.4	2.2	2.0
Harmonised	0.4	1.7	3.6	2.6	2.3	2.0
Core inflation[4]	1.5	1.2	2.8	2.3	2.4	2.0

Source: WIFO. 2013, 2014: forecast. – [1] Including adjustment for the change in net equity of households in pension fund reserves. – [2] Excluding adjustment for the change in net equity of households in pension fund reserves. – [3] End of period. – [4] Excluding unprocessed food (meat, fish, fruits, vegetables) and energy items.

Table 5: Earnings and international competitiveness

	2009	2010	2011	2012	2013	2014
	Percentage changes from previous year					
Gross earnings per employee[1]	+ 1.7	+ 1.0	+ 1.7	+ 2.9	+ 2.4	+ 2.4
Gross real earnings per employee[2]	+ 1.2	− 0.8	− 1.5	+ 0.4	+ 0.2	+ 0.4
Net real earnings per employee[2]	+ 3.0	− 1.1	− 2.0	+ 0.0	− 0.1	+ 0.1
Unit labour costs						
Total economy	+ 4.8	− 0.3	+ 0.8	+ 3.3	+ 2.7	+ 1.6
Manufacturing	+11.5	− 6.1	− 3.9	+ 3.1	+ 1.7	− 0.7
Effective exchange rate, manufactures						
Nominal	+ 0.7	− 2.6	+ 0.0	− 1.5	+ 0.9	+ 0.1
Real	+ 0.4	− 2.7	+ 1.1	− 1.4	+ 1.4	+ 0.1

Source: WIFO. 2013, 2014: forecast. – [1] Employees according to National Accounts definition. – [2] Deflated by CPI.

Fiscal consolidation path subject to major risks

While fiscal policy in Austria remains geared towards consolidation, the course is subject to manifold risks even apart from cyclical uncertainties. They relate in particular to the cost of financial market stabilisation, for which € 1.15 billion are provided in the federal budget for 2013. Yet, additional needs for distressed nationalised banks cannot be excluded either for 2013 or 2014, which would raise the government deficit above targets. Moreover, the amount and time-profile of revenues expected from bilateral tax agreements with Switzerland and Liechtenstein are uncertain. The present forecast assumes for 2013 revenues to the amount of € 0.6 billion from the agreement with Switzerland; for 2014, revenues totalling € 0.5 billion are expected from both agreements. For 2014, no revenues are foreseen from a financial transactions tax. Uncertainty also surrounds the budgetary impact of compensation for flood damages. WIFO projects a general government deficit of 2.3 percent of GDP for 2013 and of 1.7 percent of GDP for 2014.

Table 6: Labour market

		2009	2010	2011	2012	2013	2014
		Changes from previous year, in 1,000					
Demand for labour							
Persons in active employment[1]		– 44.0	+ 32.4	+ 70.4	+ 52.2	+ 26.5	+ 32.5
Employees[2]		– 48.5	+ 25.5	+ 63.3	+ 47.2	+ 22.0	+ 28.0
Percentage changes from previous year		– 1.5	+ 0.8	+ 1.9	+ 1.4	+ 0.7	+ 0.8
Nationals		– 43.0	+ 5.8	+ 25.7	+ 9.0	+ 2.0	+ 3.0
Foreign workers		– 5.5	+ 19.7	+ 37.7	+ 38.1	+ 20.0	+ 25.0
Self-employed[3]		+ 4.5	+ 6.9	+ 7.1	+ 5.0	+ 4.5	+ 4.5
Labour supply							
Population of working age	15 to 64 years	+ 17.3	+ 21.6	+ 37.0	+ 15.6	+ 3.0	+ 5.5
	15 to 59 years	+ 11.1	+ 8.9	+ 17.1	+ 19.5	+ 7.2	+ 5.3
Labour force[4]		+ 4.0	+ 22.9	+ 66.3	+ 66.1	+ 47.5	+ 41.5
Surplus of labour							
Registered unemployed[5]		+ 48.1	– 9.5	– 4.1	+ 13.9	+ 21.0	+ 9.0
In 1,000		260.3	250.8	246.7	260.6	281.6	290.6
Unemployed persons in training[5]	in 1,000	64.1	73.2	63.2	66.6	74.6	76.6
		In percent					
Unemployment rate							
Eurostat definition[6]		4.8	4.4	4.2	4.3	5.0	5.1
As a percentage of total labour force[5]		6.5	6.2	6.0	6.3	6.7	6.8
National definition[5, 7]		7.2	6.9	6.7	7.0	7.5	7.6
Employment rate							
Persons in active employment[1, 8]		64.7	65.1	65.9	66.6	67.0	67.5
Total employment[6, 8]		71.6	71.7	72.1	72.5	72.6	73.0

Source: WIFO. 2013, 2014: forecast. – [1] Excluding parental leave, military service. – [2] According to Federation of Austrian Social Security Institutions. – [3] According to WIFO. – [4] Persons in active employment plus unemployment. – [5] According to Public Employment Service Austria. – [6] According to Eurostat Labour Force Survey. – [7] As a percentage of total labour force, excluding self-employed. – [8] As a percentage of population of working age (15 to 64 years).

Possibility of a stronger upswing, but clear downward risks

In the event of a stronger rebound in foreign trade fostering business confidence, the ample liquidity available may lead to a stronger cyclical upswing. However, downward risks remain high if the recession in the euro area persists.

The mutual dependence of financial market intermediaries and government authorities remains a major problem of the euro area. The vicious circle of loss of confidence (in government bonds), instability (of banks), negative expectations and weak investment is operating unabated. The governance architecture of the euro area remains fragile and prone to external shocks, while the international environment is surrounded by considerable uncertainty. Business investment may pick up more strongly than projected and lead to a more speedy recovery in the euro area if a reform of the institutional and macroeconomic framework would succeed in restoring confidence in a lasting way. Among such reforms are the implementation of a Banking Union and an EU-wide deposit guarantee scheme, a reduction in refinancing cost and the introduction of programmes stimulating endogenous growth in the crisis countries.

While the risk of automatic budgetary cuts in the USA continues in view of the political stand-off, it can nevertheless be better evaluated after the recent experience with the "fiscal cliff" and the debt ceiling. Positive factors like innovations in energy markets imply certain upward risks, notably if they lead to higher business confidence. Likewise, the coming months will show whether the new policy strategy in Japan has a lasting effect.

Risks also emanate from global financial markets which are currently flooded by low-interest central bank credit, especially in the USA and Japan. While the easy monetary policy is necessary to set a global business cycle upswing in motion, it also carries the risk of renewed instability on financial markets. Such risk is currently most concrete for emerging markets where capital flows have been highly volatile in recent weeks.

Table 7: Key policy indicators

	2009	2010	2011	2012	2013	2014
	As a percentage of GDP					
Fiscal policy						
General government financial balance						
According to Maastricht definition	– 4.1	– 4.5	– 2.5	– 2.5	– 2.3	– 1.7
General government primary balance	– 1.3	– 1.8	+ 0.2	+ 0.1	+ 0.3	+ 0.8
	In percent					
Monetary policy						
3-month interest rate	1.2	0.8	1.4	0.6	0.2	0.2
Long-term interest rate[2]	3.9	3.2	3.3	2.4	1.8	1.8
	Percentage changes from previous year					
Effective exchange rate						
Nominal	+ 0.9	– 2.5	+ 0.1	– 1.5	+ 0.8	+ 0.2
Real	+ 0.4	– 2.7	+ 1.2	– 1.4	+ 1.3	+ 0.1

Source: WIFO. 2013, 2014: forecast. – [1] 10-year central government bonds (benchmark).

GDP growth in Austria is being constrained by the weakness of foreign demand. Companies enjoy favourable financing conditions and were able to maintain their stock of human capital by keeping staff levels stable. This implies potential upward risks for domestic demand, if the situation in major trading partner countries like Italy, France, Czech Republic or Hungary improves earlier than expected. A weaker domestic scenario than reflected in the present forecast may result from protracted stagnation or relapse into recession in the external environment.