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**Strong Growth in 2007, Sizeable
Cyclical Risks for 2008
Economic Outlook for 2007 and 2008**

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Strong Growth in 2007, Sizeable Cyclical Risks for 2008

Economic Outlook for 2007 and 2008

GDP in Austria is growing by 3.4 percent in volume this year, $\frac{3}{4}$ percentage point above the euro area average. Strong business activity is driven by exports and has meanwhile extended to construction and equipment investment. The swift expansion of demand and output is accelerating the growth of employment and of government revenues. Yet, the impact on private household consumption remains muted. The crisis on international financial markets, whose repercussions cannot be fully assessed as yet, will also exert a dampening effect. For 2008, GDP growth is expected to moderate to a rate of 2.4 percent in real terms, close to the long-term average.

In 2007, the Austrian economy is benefiting from the strong momentum of exports and investment in western and eastern Europe and is expected to grow by 3.4 percent in volume, broadly the same rate as last year. Austrian exports are rising by more than 8 percent in real terms, manufacturing output by 7.3 percent. High corporate earnings, fully utilised productive capacities and undiminished business optimism translate into a sizeable increase in investment (+8 percent for machinery and equipment). The business cycle has thereby passed the crucial stage from being entirely export driven towards taking root in investment. Further support comes from construction activity, rising by 5 percent this year, on the back of a stable expansion in civil engineering, a steady recovery of residential building and a reinforcement of industrial construction activity.

Nevertheless, the recovery is unlikely to turn into a cyclical boom, for two reasons: first, the weakening international environment in the wake of slackening activity in the USA and the global financial crisis, and second, the persistent sluggishness of private consumption in Austria.

The worldwide turbulences on financial markets originated from the sub-prime segment of the US real estate market and has been spreading since. Several banks have been faced with solvency problems, and risk premia for corporate financing have increased substantially. While timely counter-action by central banks has contributed towards calming the situation, the extent and duration of the problems in the global financial system are still unclear. Immediately affected by the crisis is the US economy. The fall in real estate prices and the scope of mortgage financing have led to a slump in housing investment, which is down by one-fifth from its peak in 2005. The drop in asset values and weaker employment growth will also dampen private household spending over the next few quarters, leading to a marked slowdown of US economic growth to annual rates below 2 percent in 2007 and 2008 and significantly adding to the risk of recession.

At present it is too early to judge to what extent the currently robust global activity will suffer from the financial market crisis. Sustained by the strong expansion in Asia, the world economy is enjoying in 2007 the fifth consecutive year of strong growth (+5 percent in volume). Notably the Chinese economy (+11 percent in 2007) is a key driver for south-east Asia and the world at large. Healthy rates of growth are recorded also for the OPEC countries, for Latin America and even Africa.

In the EU, first signs of the impact of the international financial crisis have already become visible:

- Several European banks are directly hit by the crisis in US mortgage financing.
- The dollar has come under significant downward pressure vis-à-vis the euro.
- A correction is under way also on some over-heated European real estate markets, particularly in Spain and Ireland, but also in the UK.
- Due to the weakness of consumer demand, the cyclical upturn in the euro area is lacking a broad base, making it more vulnerable to international shocks.

WIFO expects a slowdown of economic growth in the EU, to an extent currently difficult to predict. The present assumption is for GDP growth of 2.1 percent in volume in

2008 (after +2.9 percent in 2007). For the euro area, growth in 2008 (+1.9 percent) may fall back below the long-term average.

In contrast to past cyclical episodes, it is unlikely this time that lively export and investment activity will give rise to a boom in private consumption. Private household demand is falling markedly short of its momentum observed between 1998 and 2000. It is expected to edge up by only 1.9 percent in volume this year, below its long-term average already for the seventh year in a row (in 2000, the last year of a cyclical high, the increase amounted to 3.9 percent). Among the reasons for the spending restraint, sluggish private income growth stands out. While gross national income is growing rapidly, per-capita income of workers and employees is gaining only 2.6 percent in 2007. After taxes and adjusted for inflation, net real incomes are unchanged from last year. If private disposable income is nevertheless growing by 2 percent in real terms, this is entirely due to higher employment and a strong rise in property incomes. No substantial gain can be expected for 2008 either. Assuming an increase in gross nominal income per capita by 3 percent, slightly accelerating inflation (+2 percent) and somewhat higher deductions will leave a marginal 0.3 percent advance in real disposable per-capita income. Therefore, the scope for an increase in private consumption remains limited in 2008 (+2.1 percent in volume).

The strong economic growth will lead to a sizeable increase in the number of people employed, by 60,000 on annual average 2007. Owing to the boom in manufacturing industry and construction, the gains are not confined to part-time jobs, but also extend to full-time jobs. Against this background, the decline in unemployment by 15,000 (or 20,000 when participants in job training activities are included) is disappointingly small. Particularly the long-term unemployed hardly benefit from the cyclical boom, and also for young job-seekers the situation has improved little so far. The number of jobs held by foreign workers, however, is rising swiftly, whether from western, southern or eastern Europe. In 2008, the fall in unemployment will decelerate further as growth slows down, to an average jobless rate of 4.2 percent of the labour force. If unemployment does not sufficiently diminish even in times of buoyant activity, the prospects for further substantial inroads in the years to come do not appear favourable. A genuine improvement in the labour market situation over the medium

term will only be achieved by means of a coherent strategy for growth and job creation on the basis of a broad array of policy measures.

The current favourable business cycle situation is confirmed by strong increases in government revenues from corporate tax, wage tax and social security contributions. As a result, the general government deficit will narrow further, possibly to a ratio of 0.4 percent of GDP. In 2008, progress towards a balanced budget is unlikely to continue, because of the less benign cyclical outlook as well as of policy decisions on a number of additional expenditures.

The lack of a rebound in consumer demand and the repercussions of the crisis on international financial markets will dampen the cyclical upswing earlier than hoped for. GDP growth in Austria is projected to decelerate markedly in 2008, even if it should stay above the euro area average. A further reduction of unemployment as well as of the government deficit is unlikely to occur.

The cyclical slowdown may turn out more severe than assumed in this central projection, notably in case of a further weakening of the external economic conditions. The major potential risks derive from a continued appreciation of the euro, a slump in real estate prices in a number of EU countries, and from the US economy slipping into a recession.

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Projections - September 2007

Main results

Percentage changes from previous year

		2003	2004	2005	2006	2007	2008
GDP							
Volume		+ 1.2	+ 2.3	+ 2.0	+ 3.3	+ 3.4	+ 2.4
Value		+ 2.4	+ 4.4	+ 3.9	+ 5.1	+ 5.8	+ 4.4
Manufacturing¹, volume		+ 0.2	+ 2.4	+ 3.1	+ 8.8	+ 7.3	+ 3.0
Wholesale and retail trade, volume		+ 0.4	+ 1.1	+ 0.2	+ 1.0	+ 1.8	+ 2.2
Private consumption expenditure, volume		+ 1.3	+ 1.8	+ 2.0	+ 2.1	+ 1.9	+ 2.1
Gross fixed investment, volume		+ 5.9	+ 0.1	+ 0.3	+ 3.8	+ 6.3	+ 3.7
Machinery and equipment ²		+ 7.2	- 1.4	+ 0.7	+ 2.1	+ 8.0	+ 4.5
Construction		+ 4.9	+ 1.3	+ 0.1	+ 5.1	+ 5.0	+ 3.0
Exports of goods³							
Volume		+ 2.9	+ 12.5	+ 3.2	+ 6.8	+ 9.0	+ 6.5
Value		+ 1.9	+ 13.9	+ 5.4	+ 9.5	+ 10.6	+ 7.5
Imports of goods³							
Volume		+ 6.0	+ 11.7	+ 2.8	+ 3.8	+ 8.4	+ 6.2
Value		+ 5.0	+ 12.5	+ 5.9	+ 8.0	+ 9.5	+ 7.5
Current balance	€ bn	-	+ 3.99	+ 5.16	+ 8.23	+ 9.47	+ 10.46
	as a percentage of GDP	-	+ 1.7	+ 2.1	+ 3.2	+ 3.5	+ 3.7
Long-term interest rate⁴	percent	4.2	4.2	3.4	3.8	4.3	4.5
Consumer prices		+ 1.3	+ 2.1	+ 2.3	+ 1.5	+ 1.9	+ 2.0
Unemployment rate							
Eurostat definition ⁵	percent	4.3	4.8	5.2	4.8	4.3	4.2
National definition ⁶	percent	7.0	7.1	7.3	6.8	6.3	6.2
Persons in active dependent employment⁷		+ 0.2	+ 0.7	+ 1.0	+ 1.7	+ 1.9	+ 0.9
General government financial balance							
	according to Maastricht definition						
	as a percentage of GDP	- 1.6	- 1.2	- 1.6	- 1.1	- 0.4	- 0.5

¹ Value added, including mining and quarrying. ² Including other products. ³ According to Statistics Austria.

⁴ 10-year central government bonds (benchmark). ⁵ According to Eurostat Labour Force Survey. ⁶ Public Employment Service Austria, percent of total labour force excluding self employed. ⁷ Excluding parental leave, military service, and unemployed persons in training.

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Projections - September 2007

Key policy indicators

	2003	2004	2005	2006	2007	2008
<i>Fiscal policy</i>						
	As a percentage of GDP					
General government financial balance						
according to Maastricht definition	- 1.6	- 1.2	- 1.6	- 1.1	- 0.4	- 0.5
according to National accounts	- 1.8	- 1.3	- 1.7	- 1.2	- 0.5	- 0.6
General government primary balance	+ 1.3	+ 1.6	+ 1.3	+ 1.6	+ 2.3	+ 2.2
<i>Monetary policy</i>						
	Percent					
3-month interest rate	2.3	2.1	2.2	3.1	4.2	4.4
Long-term interest rate ¹	4.2	4.2	3.4	3.8	4.3	4.5
	Percentage changes from previous year					
Effective exchange rate						
Nominal	+ 4.3	+ 1.5	- 0.7	+ 0.2	+ 1.0	+ 0.6
Real	+ 3.3	+ 1.0	- 1.0	- 0.5	+ 0.6	+ 0.5

¹ 10-year central government bonds (benchmark).

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World economy

Percentage changes from previous year

	2003	2004	2005	2006	2007	2008
Real GDP						
World	+ 4.0	+ 5.3	+ 4.9	+ 5.4	+ 5.1	+ 4.8
Total OECD	+ 1.9	+ 3.2	+ 2.5	+ 3.0	+ 2.6	+ 2.3
USA	+ 2.5	+ 3.9	+ 3.2	+ 2.9	+ 1.9	+ 1.8
Japan	+ 1.4	+ 2.7	+ 1.9	+ 2.2	+ 1.8	+ 2.0
EU 27	+ 1.3	+ 2.5	+ 1.8	+ 3.0	+ 2.9	+ 2.1
EU 15	+ 1.1	+ 2.3	+ 1.6	+ 2.8	+ 2.7	+ 1.9
Euro area	+ 0.8	+ 2.0	+ 1.5	+ 2.8	+ 2.7	+ 1.9
New member states ¹	+ 4.1	+ 5.5	+ 4.7	+ 6.2	+ 5.5	+ 5.2
China	+ 10.0	+ 10.1	+ 10.2	+ 10.7	+ 11.0	+ 10.0
World trade, volume	+ 5.3	+ 10.3	+ 7.2	+ 8.9	+ 7.0	+ 7.0
Market growth²	+ 5.4	+ 9.1	+ 7.4	+ 10.3	+ 8.5	+ 6.3
Primary commodity prices						
HWWI Index, total	- 4	+ 18	+ 29	+ 19	+ 1	+ 3
Excluding energy	- 6	+ 18	+ 6	+ 22	+ 9	+ 0
Crude oil prices						
Average import price (cif) for OECD countries	28.4	36.3	50.6	61.1	64.0	69.0
Exchange rate						
USD per euro	1.131	1.243	1.245	1.256	1.35	1.40

¹ Bulgaria, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia, Slovenia.

² Real import growth of trading partners weighted by Austrian export shares.

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Projections - September 2007

Private consumption, income and prices

	2003	2004	2005	2006	2007	2008
	Percentage changes from previous year, volume					
Private consumption expenditure	+ 1.3	+ 1.8	+ 2.0	+ 2.1	+ 1.9	+ 2.1
Durables	+ 3.8	+ 4.0	+ 2.5	+ 1.9	+ 2.8	+ 3.2
Non-durables and services	+ 1.0	+ 1.5	+ 2.0	+ 2.1	+ 1.8	+ 2.0
Household disposable income	+ 2.2	+ 1.9	+ 2.6	+ 2.7	+ 2.0	+ 1.9
Household saving ratio						
As a percentage of disposable income	8.7	8.9	9.3	9.7	9.9	9.8
	Percentage changes from previous year					
Direct lending to domestic non-banks¹	+ 1.6	+ 5.0	+ 4.7	+ 4.5	+ 2.8	+ 3.8
	Percentage changes from previous year					
Inflation rate						
National	1.3	2.1	2.3	1.5	1.9	2.0
Harmonised	1.3	2.0	2.1	1.7	1.9	2.0
Core inflation ²	1.3	1.6	1.5	1.3	1.8	1.9

¹ End of period.

² Excluding unprocessed food (meat, fish, fruits, vegetables) and energy items.

Productivity

Percentage changes from previous year

	2003	2004	2005	2006	2007	2008
Total economy						
Real GDP	+ 1.2	+ 2.3	+ 2.0	+ 3.3	+ 3.4	+ 2.4
Employment ¹	- 0.0	+ 0.2	+ 0.8	+ 1.2	+ 0.9	+ 0.7
Productivity (GDP per employment)	+ 1.3	+ 2.2	+ 1.2	+ 2.1	+ 2.5	+ 1.7
Manufacturing						
Production ²	+ 0.2	+ 2.3	+ 3.2	+ 8.8	+ 7.3	+ 3.0
Employees ³	- 1.7	- 0.6	- 0.8	+ 0.2	+ 1.5	- 0.7
Productivity per hour	+ 1.5	+ 2.1	+ 4.6	+ 8.4	+ 5.8	+ 4.2
Working hours per day per employee ⁴	+ 0.3	+ 0.8	- 0.6	+ 0.2	- 0.1	- 0.5

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.

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Projections - September 2007

Earnings and international competitiveness

Percentage changes from previous year

	2003	2004	2005	2006	2007	2008
Gross earnings per employee ¹	+ 1.9	+ 1.8	+ 2.3	+ 2.7	+ 2.6	+ 3.0
Gross real earnings per employee ¹	+ 0.3	- 0.0	+ 0.6	+ 1.1	+ 0.7	+ 1.0
Net real earnings per employee ¹	+ 0.0	- 0.0	+ 1.2	+ 0.5	± 0.0	+ 0.3
<i>Total economy</i>						
Unit labour costs	+ 0.5	- 0.6	+ 1.2	+ 0.4	+ 0.1	+ 1.4
<i>Manufacturing</i>						
Unit labour costs	+ 1.2	- 0.7	± 0.0	- 4.2	- 2.8	- 0.4
Relative unit labour costs ²						
Vis-à-vis trading partners	+ 4.4	+ 1.7	+ 1.5	- 1.9	- 1.7	- 1.2
Vis-à-vis Germany	+ 2.5	+ 2.2	+ 4.4	- 0.2	± 0.0	- 0.9
Effective exchange rate - manufactures						
Nominal	+ 4.3	+ 1.5	- 0.6	+ 0.2	+ 1.0	+ 0.6
Real	+ 3.4	+ 1.1	- 0.9	- 0.5	+ 0.6	+ 0.5

¹ Employees according to National Accounts definition.

² In a common currency; minus sign indicates improvement of competitiveness.

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Labour market

Changes from previous year (1,000^s)

		2003	2004	2005	2006	2007	2008
Demand for labour							
Persons in active employment ¹		+ 8.5	+ 25.1	+ 37.2	+ 55.9	+ 65.0	+ 34.5
Employees ²		+ 5.5	+ 21.1	+ 31.9	+ 51.5	+ 60.0	+ 30.0
<i>Percentage changes from previous year</i>		+ 0.2	+ 0.7	+ 1.0	+ 1.7	+ 1.9	+ 0.9
Nationals		- 10.4	+ 9.2	+ 20.0	+ 35.0	+ 41.2	+ 19.3
Foreign workers		+ 15.9	+ 11.9	+ 11.9	+ 16.5	+ 18.8	+ 10.7
Self-employed ³		+ 3.0	+ 4.0	+ 5.3	+ 4.4	+ 5.0	+ 4.5
Labour supply							
Population of working age	(15 to 64 years)	+ 37.7	+ 34.4	+ 15.6	+ 18.5	+ 22.9	+ 25.8
	(15 to 59 years)	+ 21.2	+ 35.6	+ 48.5	+ 52.8	+ 24.3	+ 16.1
Labour force ⁴		+ 16.1	+ 28.9	+ 45.9	+ 42.4	+ 50.0	+ 33.5
Surplus of labour							
Registered unemployed ⁵		+ 7.7	+ 3.8	+ 8.8	- 13.5	- 15.0	- 1.0
	1,000 ^s	240.1	243.9	252.7	239.2	224.2	223.2
Unemployment rate							
Eurostat definition ⁶	percent	4.3	4.8	5.2	4.8	4.3	4.2
Percent of total labour force ⁵	percent	6.3	6.4	6.5	6.1	5.7	5.6
National definition ^{5,7}	percent	7.0	7.1	7.3	6.8	6.3	6.2
Employment rate							
Persons in active employment ^{1,8}	percent	62.2	62.3	62.8	63.6	64.5	64.8
Total employment (Eurostat) ^{6,8,9}	percent	-	67.8	68.6	70.2	70.8	70.9

¹ Excluding parental leave, military service, and unemployed persons in training. ² According to Federation of Austrian Social Security Institutions. ³ According to WIFO. ⁴ Economically active employment plus unemployment.

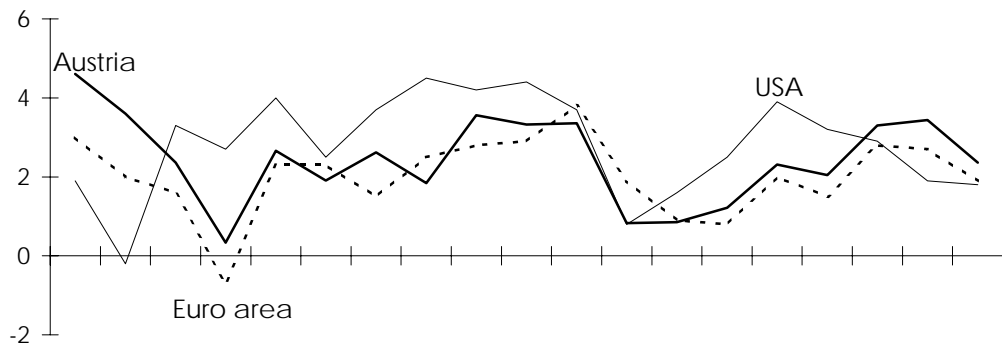
⁵ According to Public Employment Service Austria. ⁶ According to Eurostat Labour Force Survey.

⁷ Percent of total labour force excl. self-employed. ⁸ Percent of population of working age (15 to 64 years).

⁹ Changed survey method.

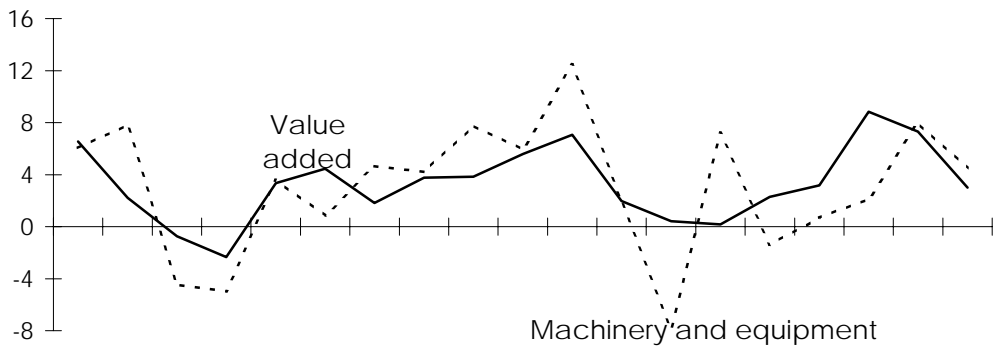
Growth of real GDP

Percent



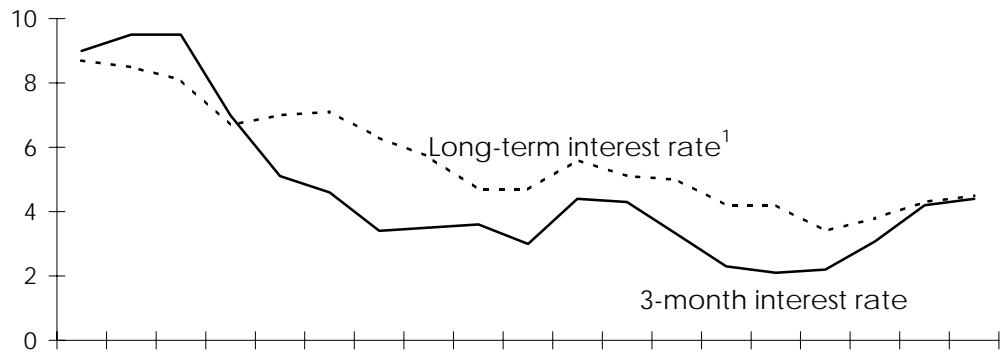
Manufacturing and investment

Percentage changes from previous year, volume



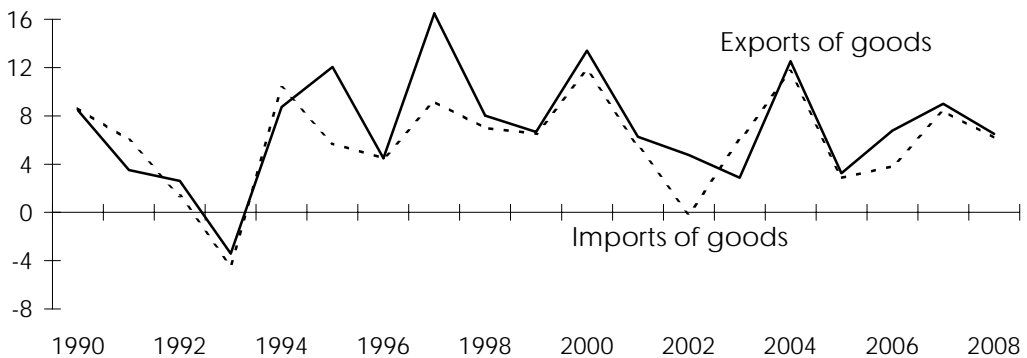
Short-term and long-term interest rates

Percent



Trade

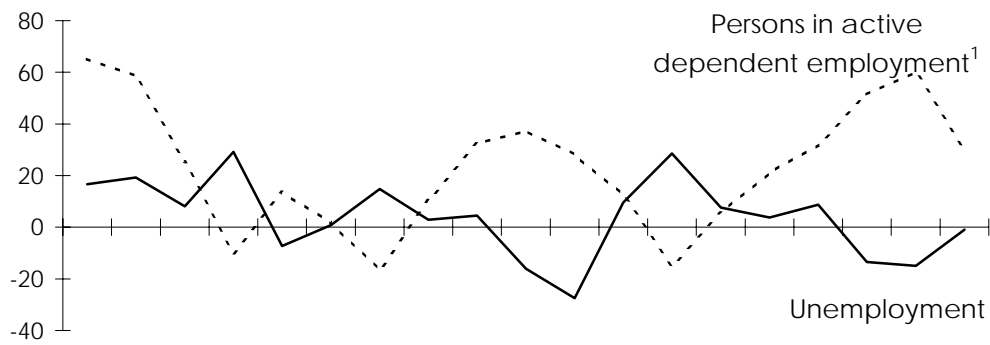
Percentage changes from previous year, volume



¹ 10-year central government bonds (benchmark).

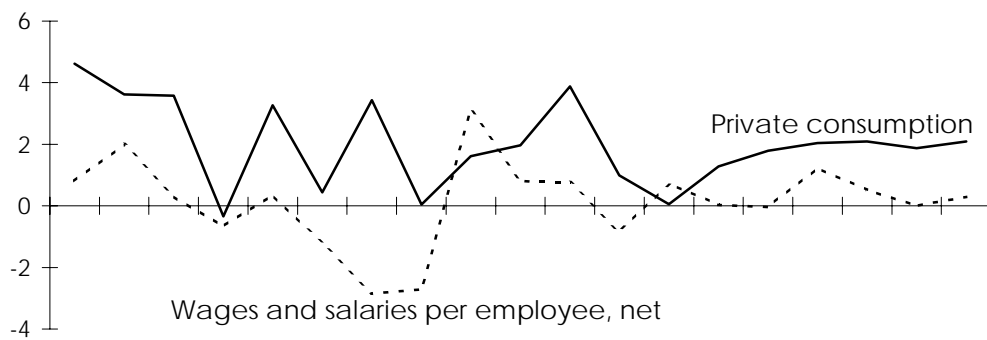
Employment and unemployment

1,000^s from previous year



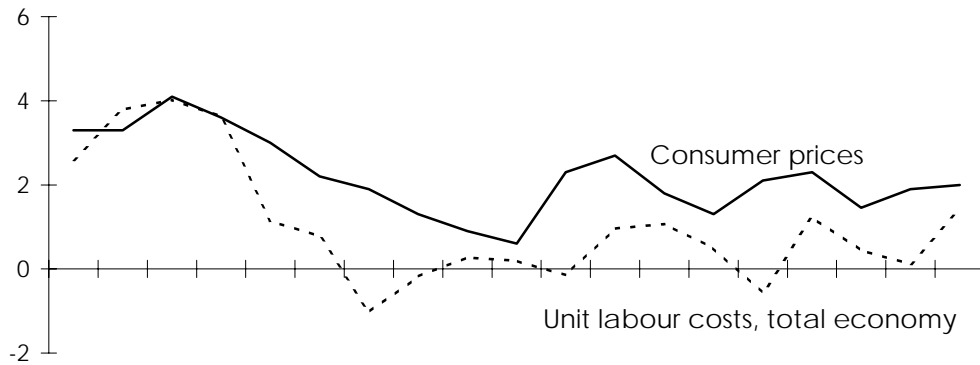
Consumption and income

Percentage changes from previous year, volume



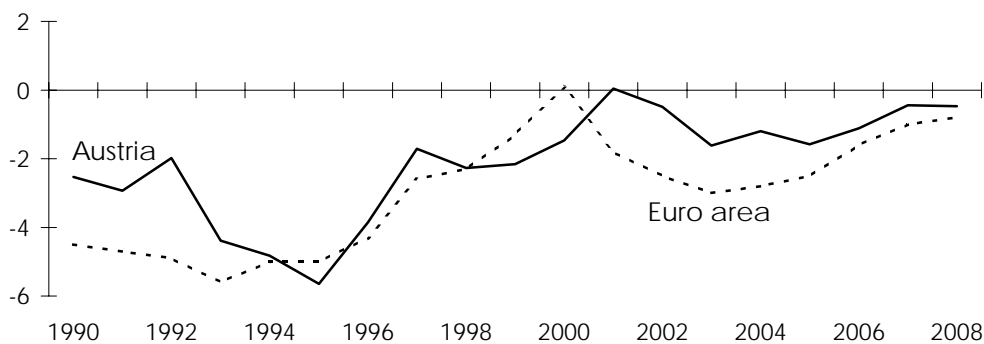
Inflation and unit labour costs

Percentage changes from previous year



General government financial balance

As a percentage of GDP



¹ Excluding parental leave, military service, and unemployed persons in training.

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