

Marcus Scheiblecker

Sovereign Debt Crisis Tightening Its Grip on the Real Economy

Economic Outlook for 2012 and 2013

The sovereign debt crisis in the euro area prompted many EU member countries to step up efforts at fiscal consolidation in order to stem the rise in interest rates on their government bonds. This will dampen internal demand in the years to come, in particular if budgetary retrenchment should lose sight of policies for long-term economic growth and labour market conditions. At the same time, business activity outside the euro area is losing momentum. As a consequence, GDP growth in Austria is projected to slow down to a modest 0.4 percent in 2012. In 2013, Austria will benefit from the expected global recovery, although growth will remain subdued at 1.6 percent in volume, given the continued restrictive stance of fiscal policy across Europe.

All staff members of the Austrian Institute of Economic Research contribute to the Economic Outlook. Data processing: Nora Popp, Roswitha Übl • Cut-off date: 19 December 2011. • E-mail address: Marcus.Scheiblecker@wifo.ac.at

The slowdown in world economic growth, already felt since last summer, is set to continue over the coming months. Given the high sovereign debt levels in several euro area countries, doubts about their sustainability has spread further across the area. In Italy, benchmark government bond yields have temporarily moved above 7 percent. Likewise, demand for French, Belgian and Spanish government bonds has slackened significantly. Meanwhile, minor increases in interest rates have been observed also in countries with below-average government debt levels like Austria or the Netherlands. Lack of confidence on the part of international financial markets has extended to almost the entire euro area.

Several years ago, extremely low short-term interest rates led many euro area countries to issue titles of short maturity. Thus, a large part of government debt will expire within the next few years and considerable amounts need to be rescheduled at high interest rates, weighing further on financial market confidence and countries' debt positions. More and more countries are therefore forced to tighten the course of fiscal restraint. Cuts in social spending and higher tax burdens will dampen domestic demand and output in the euro area.

For this reason, WIFO expects euro area GDP to stagnate in 2012. In 2013, while the area should benefit from a pickup of global economic activity, fiscal restraint will continue to act as a drag on GDP growth. Austria will particularly be negatively affected by the restrictive policy stance pursued by Italy, its second-largest trading partner. The crisis in Hungary will also show adverse effects.

The present WIFO projections, like the previous ones of last autumn, rest on the assumption that the domestic as well as the international financial system remains stable overall. For the purpose of the projections, the risk of extremely tight bank lending (credit crunch) in the context of compliance with higher equity capital requirements is considered manageable for the euro area. It is further assumed that governments will succeed in servicing their debt in an orderly way and that current high interest rates on many euro area countries' government bonds will gradually abate to more sustainable levels.

Under these assumptions, the Austrian economy should expand by no more than 0.4 percent in 2012. Exports will provide less stimulus, growing just by 2.8 percent in volume. Firms will hardly increase investment in machinery and equipment, despite higher earnings and lower interest rates enjoyed last year, nor will they be strongly inclined to embark on new construction projects.

Table 1: Main results

		2008	2009	2010	2011	2012	2013
		Percentage changes from previous year					
GDP							
Volume		+ 1.4	- 3.8	+ 2.3	+ 3.2	+ 0.4	+ 1.6
Value		+ 3.2	- 2.8	+ 4.1	+ 5.5	+ 2.7	+ 3.2
Manufacturing ¹ , volume		+ 1.3	- 15.0	+ 7.2	+ 8.0	±0.0	+ 3.5
Wholesale and retail trade, volume		- 3.0	+ 0.7	+ 3.1	+ 0.6	+ 0.5	+ 1.0
Private consumption expenditure, volume		+ 0.8	- 0.3	+ 2.2	+ 0.8	+ 0.8	+ 1.0
Gross fixed investment, volume		+ 0.7	- 8.3	+ 0.1	+ 5.6	+ 0.9	+ 1.5
Machinery and equipment		- 0.7	- 9.7	+ 4.3	+ 11.0	+ 1.5	+ 2.0
Construction		+ 1.0	- 7.6	- 2.9	+ 1.0	+ 0.4	+ 1.0
Exports of goods ²							
Volume		+ 0.5	- 16.8	+ 12.8	+ 7.8	+ 3.5	+ 6.4
Value		+ 2.5	- 20.2	+ 16.7	+ 11.5	+ 3.5	+ 7.5
Imports of goods ²							
Volume		+ 0.6	- 14.3	+ 10.3	+ 8.0	+ 3.7	+ 5.9
Value		+ 4.7	- 18.4	+ 16.5	+ 13.2	+ 3.2	+ 7.5
Current balance	billion €	+ 13.76	+ 7.49	+ 8.46	+ 7.59	+ 7.49	+ 8.35
As a percentage of GDP		+ 4.9	+ 2.7	+ 3.0	+ 2.5	+ 2.4	+ 2.6
Long-term interest rate ³	in percent	4.4	3.9	3.2	3.3	3.0	3.0
Consumer prices		+ 3.2	+ 0.5	+ 1.9	+ 3.3	+ 2.1	+ 1.9
Unemployment rate							
Eurostat definition ⁴	in percent	3.8	4.8	4.4	4.2	4.5	4.7
National definition ⁵	in percent	5.9	7.2	6.9	6.8	7.1	7.4
Persons in active dependent employment ⁶		+ 1.7	- 1.5	+ 0.8	+ 1.9	+ 0.6	+ 0.4
General government financial balance							
according to Maastricht definition							
As a percentage of GDP		- 0.9	- 4.1	- 4.4	- 3.3	- 3.0	- 2.8

Source: WIFO Economic Outlook. – 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.

In view of the sluggish business activity, commodity prices should ease in the course of 2012. Domestic headline inflation may abate to 2 percent and prevent further losses of private household purchasing power. In this way, a projected increase in private consumption of 0.8 percent should come to support overall business activity.

The slowdown of demand and output growth will leave its trace also on the labour market where the gain in overall employment may decelerate to 0.6 percent on average in 2012. The unemployment rate should climb back above 7 percent, close to its peak during the crisis of 2009.

The forecast assumes that policy in Austria will maintain the course of fiscal consolidation and, despite the quasi-stagnation of economic activity, underpin it by structural measures supporting growth over the medium term. The general government deficit should thereby edge down from 3.3 percent of GDP in 2011 to 3 percent of GDP in 2012. With growth picking up and structural consolidation measures showing effect, government net borrowing should decline to 2.8 percent of GDP in 2013.

Both the OECD Leading Indicators and the Ifo Business Climate Index for the world economy have been declining since the spring of 2011, signalling a global cyclical slowdown, with the exception of the USA and of Japan, where reconstruction works following the earthquake of last March stimulate economic activity. The growth momentum is also decelerating in major emerging markets and developing countries.

GDP in the USA expanded in the course of 2011, although the results for the first and second quarter were revised down. After an anaemic first quarter (+0.1 percent from the previous period), demand and output gained 0.3 percent in the second and 0.5 percent in the third quarter. Private consumption and net exports were the driving forces in the third quarter. Although demand for machinery and equipment was also buoyant, the drawdown of inventories acted as a drag on overall investment. The Purchasing Managers Index picked up in November, after having stagnated during the months before. Production should thus have been heading up in the fourth quarter.

The US labour market is improving only gradually. After the latest crisis, unemployment was untypically sticky. In November 2011, the seasonally-adjusted unemployment rate edged down to 8.6 percent, undershooting its long-term peak of 10.1 percent of October 2009 by only 1½ percentage points. Household survey results give rise to cautious optimism: both the Consumer Sentiment Index and the Consumer Confidence Index posted significant gains in November.

Global economic growth slowing down

Leading indicators for the global economy have been steadily pointing downwards since the spring of 2011. In the USA, business activity should rebound shortly, but restrictive fiscal policy is likely to dampen the pace of growth.

Table 2: World economy

	2008	2009	2010	2011	2012	2013
	Percentage changes from previous year					
<i>Real GDP</i>						
World	+ 2.8	- 0.7	+ 5.1	+ 3.8	+ 3.2	+ 4.2
USA	- 0.3	- 3.5	+ 3.0	+ 1.6	+ 1.3	+ 1.6
Japan	- 1.0	- 5.5	+ 4.4	- 1.0	+ 1.5	+ 2.3
EU 27	+ 0.3	- 4.3	+ 1.9	+ 1.7	+ 0.3	+ 1.7
Euro area 16	+ 0.4	- 4.2	+ 1.9	+ 1.7	± 0.0	+ 1.3
Germany	+ 1.1	- 5.1	+ 3.7	+ 3.1	+ 0.5	+ 1.6
New EU countries ¹	+ 4.1	- 3.2	+ 2.4	+ 3.1	+ 1.4	+ 3.1
China	+ 9.6	+ 9.2	+ 10.4	+ 9.5	+ 8.2	+ 9.2
World trade, volume	+ 2.7	- 12.8	+ 15.0	+ 6.0	+ 4.2	+ 6.5
Market growth ²	+ 2.9	- 11.5	+ 11.4	+ 7.5	+ 3.0	+ 6.0
<i>Primary commodity prices</i>						
HWI index, total	+ 31.7	- 34.4	+ 29.0	+ 35	- 12	+ 6
Excluding energy	+ 18.3	- 28.0	+ 31.5	+ 25	- 5	+ 10
<i>Crude oil prices</i>						
Brent, \$ per barrel	97.0	61.5	79.5	110	95	100
<i>Exchange rate</i>						
\$ per euro	1.471	1.393	1.327	1.40	1.30	1.30

Source: WIFO Economic Outlook. – ¹ Bulgaria, Czech Republic, Hungary, Latvia, Lithuania, Poland, Romania. – ² Real import growth of trading partners weighted by Austrian export shares.

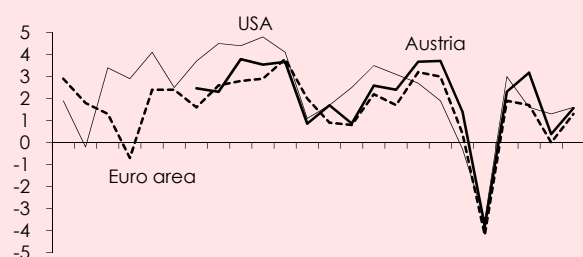
Private consumption may nevertheless rise only modestly in 2012. While fiscal policy was still markedly expansionary in 2011, the US government will take action to unwind the high public debt. WIFO therefore expects GDP growth to moderate from 1.6 percent in 2011 to 1.3 percent in 2012, before re-accelerating in the following year to an annual 1.6 percent, a rate still below those recorded before the crisis.

In Japan, the cyclical pattern has been distorted by one-off factors in 2011. In the first quarter, real GDP fell by 1.7 percent from the earlier period as a consequence of the environmental disaster. After a further decline in the second quarter, growth resumed at a rate of 1.4 percent with the beginning of reconstruction works. For 2012, WIFO expects GDP growth to average 1.5 percent, accelerating to 2.3 percent with the global recovery in 2013.

Figure 1: Indicators of economic performance

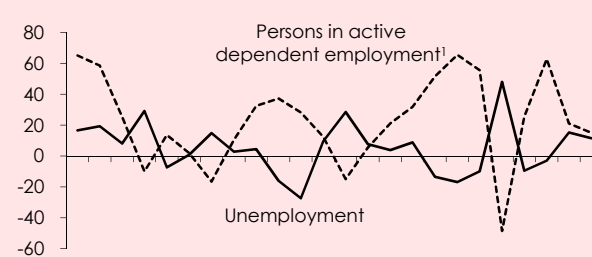
Growth of real GDP

Percent



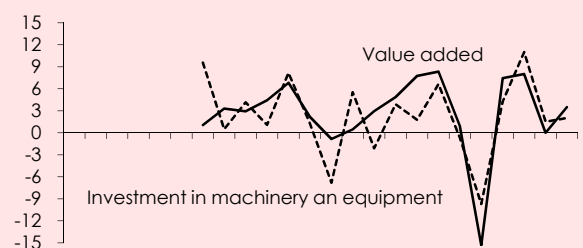
Employment and unemployment

1,000 from previous year



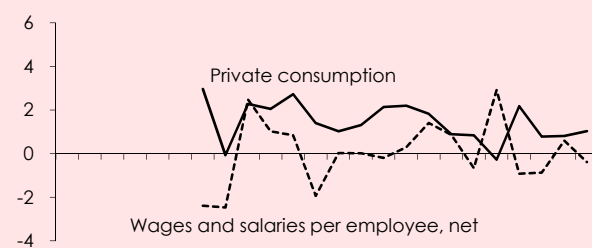
Manufacturing and investment

Percentage changes from previous year, volume



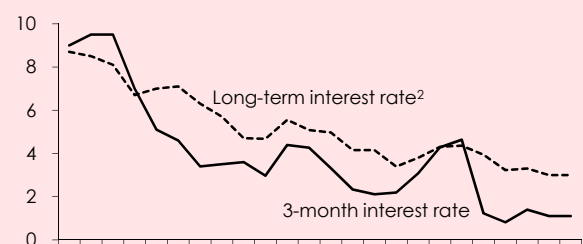
Consumption and income

Percentage changes from previous year, volume



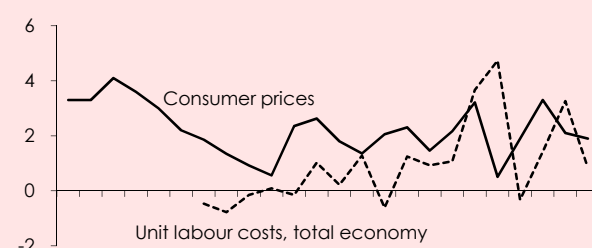
Short-term and long-term interest rates

Percent



Inflation and unit labour costs

Percentage changes from previous year



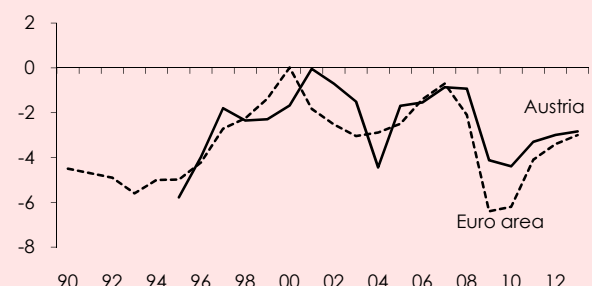
Trade

Percentage changes from previous year, volume



General government financial balance

As a percentage of GDP



Source: WIFO Economic Outlook. – ¹ Excluding parental leave, military service, and unemployed persons in training. – ² 10-year central government bonds (benchmark).

The Chinese economy, for its part, looks set for a soft landing from the earlier boom. While quarterly GDP growth of 2.3 percent in the third quarter 2011 almost matched the rate of the previous period, several indicators point to an imminent cyclical slowdown, and monetary policy is changing course. Thus, the official Purchasing Managers Index fell below the 50-points threshold last November, for the first time since February 2009, and also the OECD Leading Indicators weakened further in October. Starting from the middle of 2012, the expansionary cyclical forces should re-

sume, supported by the latest move by the Central Bank to loosen the monetary reins. After a dent in 2012, Chinese economic growth should rebound in 2013.

The slowdown in the euro area will hold back business activity also in the new EU member countries of East-Central Europe. Overall, GDP growth in the latter seven member countries of 3.1 percent in 2011 substantially exceeded the euro area average of 1.7 percent, implying a resumption of the catching-up process.

In the past, an important driver of the catching-up process has been domestic demand: both private consumption and business fixed investment expanded swiftly, propelled by abundant financing from abroad. Austrian banks were largely involved in this process. Since the current government debt crisis in the euro area has undermined the equity capital endowment of European banks, the latter are becoming more cautious in their lending, notably in countries outside the euro area.

GDP growth in the region will therefore slow down in 2012 in parallel with the trend in the old Member States. WIFO expects aggregate real GDP in East-Central Europe to gain 1.4 percent, before benefiting from the international cyclical revival in 2013 with projected growth of 3.1 percent.

The euro area economy is entering a difficult phase in 2012. The international cyclical slowdown will take its toll on export growth. Unlike in the past, economic policy will in the majority of countries not be able to counter weaker external demand by expansionary measures. On the contrary, many countries will be forced to reinforce fiscal restriction in order to reassure financial markets of their sound budgetary management and thereby obtain a turnaround of the recent swift climb in government bond yields.

However, the latest decisions of the European Council in favour of tighter fiscal consolidation and sanctions in case of non-compliance may prove insufficient as to lead to a swift decline in sovereign bond yields. Financial markets remain sceptical as stronger fiscal restriction is not being adequately accommodated by the ECB, and the European financial stability mechanisms are of complicated institutional design. With Greek government bonds still carrying interest rates of around 30 percent on secondary markets, the country remains excluded from market financing of fresh debt. Portuguese bond yields have also reached nearly 12 percent, those for Spain over 6 percent on the monthly average for November. Meanwhile, the confidence crisis has spread to Italy whose government debt rose above 120 percent of GDP in 2011. Recently, the government had to pay a risk premium of 7.9 percent on new financial market debt. Similarly, financial conditions are weakening for France and Austria, where yields moved from 2.6 percent each in September 2011 to 3.4 percent in November. Austria's government debt-to-GDP ratio of 72 percent is below the 85 percent recorded for France.

Only Germany has so far escaped from a rise in market rates. Indeed, financial conditions even improved over the last months in view of the uncertainty prevailing on international markets. With the sovereign debt crisis spreading, international rating agencies hold out the prospect of downgrading even the euro area countries that so far enjoyed top ratings.

Against the background of unforeseeable market developments and standard policy reactions, the present forecast for the euro area carries an unusually wide margin of uncertainty. Underlying the forecast are in particular the following assumptions:

- Over the forecast period, the euro area will be spared an unilateral debt default of any of its members;
- The euro area banking systems remains essentially stable. Only in a limited number of cases, banks may have to rely on government support for fresh equity capital.
- The necessary efforts of fiscal consolidation will effectively proceed in a coordinated way. Those countries which enjoy favourable financial terms and are

Credit restrictions dampen domestic demand in East-Central Europe

Stagnation in the euro area

Two factors will hold back economic activity in the euro area in 2012: the weakening international environment and, at the same time, the squeeze of internal demand on account of fiscal restraint. As a result, euro area GDP is expected to quasi-stagnate. Strategies for higher growth, such as proposed by the Europe 2020 Initiative, risk being deferred.

thus less under pressure of fiscal retrenchment will adopt a more accommodating stance in order to avoid further drag on economic activity in the area.

The real economy of the euro area, though having lost momentum since early 2011, has nevertheless resisted relatively well to the turbulences on financial and capital markets. GDP growth slowed markedly, from 0.8 percent in the first to 0.2 percent in the second quarter, but no further in the following three-months period.

A turnaround has, however, been observed already for the seasonally-adjusted euro area unemployment rate which declined until April 2011, but has been heading up since. It rose gradually from 9.9 percent in April to 10.3 percent in October.

The industrial confidence indicator has dropped markedly since spring 2011, the consumer sentiment index has joined the negative trend since last summer. Although business confidence weakened less in October and remained flat in November, incoming orders declined substantially in recent months. The same pattern has been observed for Germany where new industrial orders shrank for three months in a row. In October, orders bounced back, though only partly offsetting previous losses. These indicators suggest that the euro area economy may fall into stagnation towards the end of 2011, with slackening orders possibly implying output losses going forward.

WIFO expects the euro area economy to stagnate on annual average 2012. While internal demand is set to remain sluggish also in 2013, due to continuing fiscal restraint, exports should benefit from a revival of global business activity. This will be supported by the lagged effects of euro depreciation from a projected 1.40 \$ to 1.30 \$ per € in 2012.

Monetary policy is likely to stay on an expansionary course for some time. After having raised the benchmark interest rate by 25 basis points each in April and July 2011, the ECB was prompted to reverse course and lowered the key intervention rate by ¼ percentage point each in November and December. In September and October, the ECB supplied commercial banks with additional liquidity to the amount of € 260 billion, a plus of nearly 13 percent from end-August. The present forecast assumes no further moves in policy-controlled interest rates until the end of 2013.

Both the trend of quarterly GDP and recent business survey results confirm the gradual slackening of business activity in Austria during 2011. Growth of seasonally-adjusted GDP decelerated from 0.9 percent in the first to 0.5 percent in the second and 0.3 percent in the third quarter, as the previously powerful stimulus from external demand faded.

Business survey results cite lower export orders as the reason for waning optimism. In the WIFO survey of last November, firms reported a further decline in orders from abroad, boding ill for short-term export prospects.

Apart from the cyclical downturn outside the euro area, additional factors will be at work in 2012 in Austria's foreign trade with neighbouring countries. Thus, Italy's economy will be subjected to a strict austerity programme. Italy is Austria's second-most-important trading partner with a share of 8 percent in total merchandise exports and of 3 percent in total overnight stays in tourism. Also in Hungary, with a share of 3 percent in exports of goods, problems look set to exacerbate in 2012. Domestic demand will be held back by forceful fiscal consolidation that is likely to tilt the economy into recession.

For Germany, Austria's most important trading partner, WIFO also expects a significant setback to growth in 2012. Although GDP is projected to edge up by 0.5 percent, it will largely be sustained by domestic demand implying only limited stimulus for Austria's exports.

Austrian exports are therefore anticipated to decline on a seasonally-adjusted basis in the first six months of 2012. Around the middle of the year, a revival of international business activity should give fresh momentum to foreign trade. On annual average, Austrian merchandise exports are forecast to expand by 3½ percent in volume. As a consequence of the slackening foreign demand, domestic manufacturing output in

Economic activity in Austria slackening markedly

In 2012, exports will barely function as the driver of demand and output growth in Austria. Domestic demand will become the crucial factor. Overall, GDP is likely to edge up by a modest 0.4 percent in volume.

2012 is unlikely to rise in volume above the year-earlier level. Output growth should resume in 2013, at a rate of 3½ percent.

Also the export of services will be adversely affected by the weaker external environment. Tourism exports, having slightly declined in 2011, may suffer a stronger setback of 3 percent in inflation-adjusted terms.

Table 3: Productivity

	2008	2009	2010	2011	2012	2013
	Percentage changes from previous year					
<i>Total economy</i>						
Real GDP	+ 1.4	- 3.8	+ 2.3	+ 3.2	+ 0.4	+ 1.6
Employment ¹	+ 2.1	- 0.9	+ 0.8	+ 2.0	+ 0.8	+ 0.7
Productivity (GDP per employment)	- 0.7	- 2.9	+ 1.5	+ 1.2	- 0.4	+ 0.8
<i>Manufacturing</i>						
Production ²	+ 0.9	- 15.3	+ 7.4	+ 8.0	± 0.0	+ 3.5
Employees ³	+ 1.7	- 5.3	- 1.3	+ 1.9	- 1.5	- 0.5
Productivity per hour	- 0.3	- 7.3	+ 5.6	+ 5.5	+ 2.3	+ 3.8
Working hours per day per employee ⁴	- 0.5	- 3.6	+ 3.0	+ 0.5	- 0.8	+ 0.2

Source: WIFO Economic Outlook. – 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.

Gross fixed investment showed a rather uneven pattern in 2011. Construction could hardly rid itself from the persistent crisis of the last years. A tentative pick-up of construction investment in the first half of the year ebbed thereafter. Much more lively was the demand for machinery and equipment, with an annual increase of 11 percent. While in the first three quarters investment in machinery and electronic goods rose by 7 percent year-on-year, purchases of motor vehicles jumped by over 25 percent. The turbulences in the euro area and concerns about the short-term outlook have apparently encouraged investment spending, given firms' generally satisfactory liquidity situation. Yet, WIFO expects a sharp deceleration of machinery and equipment investment to a rate of 1.5 percent in real terms in 2012 and of 2 percent in 2013. Construction activity will remain subdued over the forecast horizon, with projected growth rates of ½ percent in volume in 2012 and 1 percent in 2013.

Like in the euro area at large, Austria's financial institutions are faced with the task of raising their equity capital ratios to 9 percent of their balance sheet total by mid-2012, as prescribed by the European Banking Authority. Given that at present market conditions a raise of fresh equity capital is rather unattractive, the alternative would be a cut in balance sheet totals, with potential negative repercussions on domestic bank lending. While it is normal that credit extension diminishes in a cyclical downturn, the reason is generally lower demand of credit on the part of companies and households.

In November 2011, about one-third of firms sampled in the regular WIFO Business Cycle Survey considered current bank lending conditions restrictive, 60 percent as "normal", and less than one-tenth as accommodating. More critical judgements came from those firms that actually were in need of credit, as 44 percent of them rated banks' current credit standards as restrictive.

During the last severe recession of 2008-09, WIFO had on behalf of Oesterreichische Nationalbank also asked domestic companies for their judgement on credit restraint. At the time, the survey revealed no restrictions that would go beyond the normal cyclical pattern. WIFO therefore does not expect major credit constraints in 2012 either. The ECB is unlikely to raise its key interest rate over the forecast horizon. The inter-bank 3-months lending rate should in both years stay slightly above the key intervention rate of 1 percent. In such environment, the outstanding domestic credit total is projected to expand by an annual 2½ percent, similar to the rate of 2.3 percent observed in 2011.

**Financial market
conditions in Austria
barely deteriorating**

According to the quarterly national accounts, private consumption during the first nine months of 2011 rose by an inflation-adjusted 0.7 percent year-on-year. Car purchases were lively in the first half of the year. For the entire year, private household spending growth is expected at 0.8 percent in real terms.

Conditions for further stable growth seem to be in place also for 2012. Negotiated wage settlements will make for an increase in total wages and salaries by 3.7 percent. At the same time, headline inflation should moderate from an annual average of 3.3 percent in 2011 to 2.1 percent, thereby strengthening households' purchasing power. Moreover, the private saving ratio should edge down further, from 7.5 percent to 7.3 percent of disposable income, judging by the typical cyclical behaviour. Thus, private consumption may keep rising by 0.8 percent in real terms in 2012, despite a weakening labour market. In the event, a rate of 0.8 percent would be twice as high as GDP overall, confirming the role of consumption as major cyclical stabiliser. With the assumed recovery in 2013, consumption growth may edge up to 1 percent, accompanied by a slight increase in the saving ratio.

Robust private consumption sustaining domestic activity

Significant gains in private earnings and decelerating inflation should ensure stable growth of private consumption in 2012, despite the business cycle downturn.

Table 4: Private consumption, income and prices

	2008	2009	2010	2011	2012	2013
	Percentage changes from previous year					
Private consumption expenditure	+ 0.8	- 0.3	+ 2.2	+ 0.8	+ 0.8	+ 1.0
Durables	+ 3.7	+ 0.9	+ 5.8	+ 0.4	- 0.3	+ 0.3
Non-durables and services	+ 0.5	- 0.4	+ 1.8	+ 0.8	+ 0.9	+ 1.1
Household disposable income	+ 0.9	- 1.7	- 0.3	- 0.0	+ 0.5	+ 1.4
	As a percentage of disposable income					
Household saving ratio ¹	11.5	10.7	8.3	7.5	7.3	7.6
Household saving ratio ²	11.4	10.1	7.8	7.1	6.8	7.1
	Percentage changes from previous year					
Direct lending to domestic non-banks ³	+ 7.4	- 1.3	+ 2.9	+ 2.3	+ 2.4	+ 2.5
	Percentage changes from previous year					
Inflation rate						
National	3.2	0.5	1.9	3.3	2.1	1.9
Harmonised	3.2	0.4	1.7	3.5	2.3	2.0
Core inflation ⁴	2.4	1.5	1.2	2.7	2.1	1.9

Source: WIFO Economic Outlook. – 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

	2008	2009	2010	2011	2012	2013
	Percentage changes from previous year					
Gross earnings per employee ¹	+ 3.2	+ 1.6	+ 1.2	+ 2.7	+ 2.9	+ 1.8
Gross real earnings per employee ²	- 0.0	+ 1.1	- 0.7	- 0.6	+ 0.8	- 0.1
Net real earnings per employee ²	- 0.7	+ 2.9	- 0.9	- 0.9	+ 0.6	- 0.4
<i>Total economy</i>						
Unit labour costs	+ 3.7	+ 4.7	- 0.3	+ 1.4	+ 3.3	+ 0.8
<i>Manufacturing</i>						
Unit labour costs	+ 5.2	+ 15.1	- 5.7	- 2.8	+ 1.7	- 2.7
Effective exchange rate, manufactures						
Nominal	+ 1.1	+ 0.7	- 2.6	+ 0.3	- 0.7	± 0.0
Real	+ 0.6	+ 0.4	- 2.7	+ 0.9	- 0.5	+ 0.1

Source: WIFO Economic Outlook. – ¹ Employees according to National Accounts definition. – ² Deflated by CPI.

Buoyant business activity in 2011 paved the way for a steady increase in employment. The number of persons in dependent active employment rose on annual average in 2011 by nearly 63,000 or 1.9 percent, almost as strongly as in the last boom year 2007 (+65,500 or 2.1 percent). It was only as from September that the monthly figures suggested a slight deceleration of the pace of job creation. With the cyclical slowdown, employment growth will come to a halt in the course of 2012. On annual average, an increase by 21,000 persons or 0.6 percent is expected. Only by 2013, with the cyclical recovery, employment growth is likely to resume, at an annual amount of 15,000 new jobs or +0.4 percent.

Whereas employment increased from month to month, seasonally adjusted unemployment turned around already as from spring 2011, from a low 242,000 in March to over 254,000 in November. For the entire year, the jobless figure will average close to 248,000, still a decline of around 1 percent from 2010.

Labour market conditions deteriorating

In 2012, the hitherto lively job creation will lose momentum. The jobless rate will trend up both in 2012 and 2013.

Table 6: Labour market

		2008	2009	2010	2011	2012	2013
		Changes from previous year, in 1,000					
<i>Demand for labour</i>							
Persons in active employment ¹		+ 66.0	- 44.0	+ 31.3	+ 68.3	+ 26.0	+ 20.0
Employees ²		+ 55.6	- 48.5	+ 25.5	+ 62.8	+ 21.0	+ 15.0
Percentage changes from previous year		+ 1.7	- 1.5	+ 0.8	+ 1.9	+ 0.6	+ 0.4
Nationals		+ 31.1	- 43.0	+ 5.8	+ 25.3	+ 10.0	+ 7.0
Foreign workers		+ 24.5	- 5.5	+ 19.7	+ 37.5	+ 11.0	+ 8.0
Self-employed ³		+ 10.4	+ 4.5	+ 5.8	+ 5.5	+ 5.0	+ 5.0
<i>Labour supply</i>							
Population of working age							
	15 to 64 years	+ 27.7	+ 17.3	+ 21.6	+ 32.8	+ 15.0	+ 6.7
	15 to 59 years	+ 17.6	+ 11.1	+ 8.9	+ 16.8	+ 14.7	+ 10.8
Labour force ⁴		+ 56.0	+ 4.0	+ 21.8	+ 65.3	+ 41.2	+ 31.5
<i>Surplus of labour</i>							
Registered unemployed ⁵		- 10.0	+ 48.1	- 9.5	- 3.0	+ 15.2	+ 11.5
In 1,000		212.3	260.3	250.8	247.8	263.0	274.5
Unemployed persons in training ⁵							
	in 1,000	50.5	64.1	73.2	63.2	63.2	63.2
In percent							
Unemployment rate							
Eurostat definition ⁶		3.8	4.8	4.4	4.2	4.5	4.7
As a percentage of total labour force ⁵		5.3	6.5	6.2	6.0	6.4	6.6
National definition ^{5,7}		5.9	7.2	6.9	6.8	7.1	7.4
Employment rate							
Persons in active employment ^{1,8}		65.7	64.7	65.0	65.9	66.1	66.4
Total employment ^{6,8}		72.1	71.6	71.7	72.2	72.4	72.5

Source: WIFO Economic Outlook. – 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).

Due to higher labour supply, the substantial net gain in the number of jobs led only to a slight decline in unemployment in 2011. Reasons were the full liberalisation of labour mobility vis-à-vis the new EU member countries as of May 2011, a cut in enrolment in job training activities (as a substitute for open unemployment) by 10,000 persons, and the statistical inclusion of 6,500 people receiving means-tested social assistance among the unemployed. In 2012, the number of registered unemployed will again rise by some 15,000. In 2013, with the cyclical recovery, the increase should moderate to 11,500.

The rate of unemployment calculated according to the conventional national method is projected to rise from 6.8 percent in 2011 to 7.1 percent in 2012 and 7.4 percent in 2013. On Eurostat definitions, the corresponding trend increase over the forecast period will be from 4.2 percent to 4.5 percent and 4.7 percent.

Methodological Notes and Short Glossary

Period comparisons

Time-series comparisons with the previous period, e.g., the previous quarter, are adjusted for seasonal effects. They also include effects that result from a different number of working days in the period (e.g., Easter). In the text, reference is made to "seasonally and working day adjusted changes".

The phrase "changed compared with a year before . . .", on the other hand, describes a change compared with the same period a year before and refers to unadjusted time series.

The analysis of the seasonally and working day adjusted development provides more precise information about the actual course of economic activity and shows turning points sooner. However, the data are subject to additional revisions as seasonal adjustment is based on statistical methods.

Average rates of change

The time given refers to the initial and the final value of the period of computation: hence the average rate 2005-2010 comprises as the first rate of change that from 2005 to 2006, and as the last that from 2009 to 2010.

Real and nominal values

In principle, the values shown must be understood as real values, i.e., adjusted for price effects. Whenever values are shown as nominal values (e.g., foreign trade statistics), this is specifically mentioned.

Production Sector

This term comprises the NACE-2008 sections B, C and D (Mining and Quarrying, Manufacturing, Energy Supply) and is here used in an international comparison.

Inflation, CPI und HICP

The inflation rate measures changes in consumer prices compared with a year before. The Consumer Price Index (CPI) is a measure of national inflation. The Harmonised Index of Consumer Prices (HICP) is the basis for comparable measurement of inflation in the EU and for the evaluation of price stability in the euro area (see <http://www.statistik.at/>).

Core inflation as a monetary policy indicator is not clearly defined. WIFO follows the common practice of using the inflation rate excluding the product categories unprocessed food and energy for core inflation. Thus just under 87 percent of the goods and services contained in the consumer price index (CPI 2010) are included in the calculation of core inflation.

WIFO Business Cycle Survey and WIFO Investment Survey

The WIFO Business Cycle Survey is a monthly survey in which around 1,100 Austrian firms are asked to assess their current and future economic situation. The WIFO Investment Survey is conducted twice a year, asking companies about their investment activity (<http://www.itkt.at/>). The indicators are balances between the positive and negative responses expressed as a percentage of the total number of firms sampled.

Unemployment rate

Austrian national definition: The number of persons registered as job seekers with the Public Employment Service expressed as a percentage of the dependent labour force. Labour force is the sum of the unemployed and the persons in dependent employment (measured in standard employment relationships). Database: registrations with the Public Employment Service (AMS) and Association of Austrian social insurance agencies.

Definition according to ILO and EUROSTAT: Any person who is not gainfully employed and is actively seeking work is considered unemployed. Gainfully employed persons comprise all persons who during the reference week worked for at least one hour in a self-employed capacity or in paid employment. Persons receiving child-care benefit and apprentices are classified as gainfully employed, whereas persons in military service or persons carrying out alternative service are not. The unemployment rate is the number of unemployed persons expressed as a percentage of the total labour force (unemployed persons plus gainfully employed persons). Database: data from household surveys ("Mikrozensus").

Terms used in connection with the national definition of the unemployment rate

Persons in training: Persons who at a set date are enrolled in AMS (Public Employment Service) training programmes. When calculating the unemployment rate, their number is not taken into account either in the denominator or in the numerator.

Persons in dependent active employment: "Persons in dependent employment" include persons receiving child-care benefit, as well as persons in military service or persons carrying out alternative service with a valid employment contract. By deducting their number one arrives at the number of "persons in dependent active employment".

In view of the increase in interest rates on international financial markets, many countries step up their efforts to improve their government balances. If this fiscal retrenchment is carried out in an uncoordinated way, it may lead to a self-reinforcing downturn in business activity.

The cyclical downswing will burden also the Austrian general government budget. With the weakening of labour market conditions, less revenue from wage-related taxes and social contributions will accrue, while receipts from profit-related taxes will decline. At the same time, additional claims for unemployment support will drive up expenditure. As a result, the government balance will weaken for cyclical reasons, while having a stabilising influence on incomes of private households and companies.

The commitment of the federal government to accelerate deficit reduction and arrive at a balanced budget by 2017 requires firm adherence to the consolidation course adopted. Structural measures of fiscal retrenchment should be taken particularly in areas where potential efficiency gains may be achieved and should underpin a sustainable budgetary improvement over the medium term.

To what extent the consolidation efforts will weigh on business activity depends on the design of the strategy. The sharper the cyclical downturn internationally and in Austria, the more important it will be not to exacerbate the cyclically-induced fiscal deterioration by additional discretionary restriction. The initial cost of reforms that can be expected to dampen public expenditure growth in the future should be accepted without offsetting budgetary cuts elsewhere.

Cyclical weakness complicates fiscal consolidation

The weakening of business conditions will weigh anew on government finances. Budgetary consolidation will need to give due respect to its implicit effects on economic growth.

Table 7: Key policy indicators

	2008	2009	2010	2011	2012	2013
	As a percentage of GDP					
<i>Fiscal policy</i>						
General government financial balance						
According to Maastricht definition	- 0.9	- 4.1	- 4.4	- 3.3	- 3.0	- 2.8
According to National Accounts	- 1.0	- 4.1	- 4.4	- 3.3	- 3.0	- 2.8
General government primary balance	+ 1.7	- 1.3	- 1.7	- 0.6	- 0.3	- 0.2
	In percent					
<i>Monetary policy</i>						
3-month interest rate	4.6	1.2	0.8	1.4	1.1	1.1
Long-term interest rate ¹	4.4	3.9	3.2	3.3	3.0	3.0
	Percentage changes from previous year					
<i>Effective exchange rate</i>						
Nominal	+ 1.2	+ 0.9	- 2.5	+ 0.3	- 0.6	± 0.0
Real	+ 0.6	+ 0.4	- 2.7	+ 0.9	- 0.5	+ 0.1

Source: WIFO Economic Outlook. – ¹ 10-year central government bonds (benchmark).