

Gerhard Rünstler

Cyclical Upswing, But Lasting Uncertainty

Economic Outlook for 2010 and 2011

Benefiting from the depreciation of the euro in the first half of the year, euro area exports should keep their upward trend in the remainder of 2010. At the same time, however, economic growth is set to slow down somewhat in the USA and in Asia. In 2011, the cyclical upswing in the euro area will maintain a moderate pace. While industrial activity should prove resilient, the high government deficits and imminent consolidation moves, hesitant private investment behaviour, the need for financial sector reform and macroeconomic imbalances within the euro area will weigh on demand and output growth. For Austria, WIFO expects real GDP to expand by 2.0 percent in 2010 and 1.9 percent in 2011. The revival of business activity will contribute to improvements in the labour market and in public finances. By 2011, the unemployment rate should ease to 6.8 percent of the dependent labour force, and the government deficit, including the planned consolidation measures, should narrow to 3.5 percent of GDP.

All staff members of the Austrian Institute of Economic Research contribute to the Economic Outlook. Data processing: Nora Popp, Roswitha Übl • Cut-off date: 22 September 2010. • E-mail address: Gerhard.Ruenstler@wifo.ac.at

With some delay vis-à-vis the USA and Asia, a strong upturn in industrial activity has now set in also in the euro area. On the back of a weaker euro exchange rate and the unabated booming demand from Far East, exports powered ahead in the second quarter 2010 and fuelled internal demand, despite the turbulences of April and May triggered by the high government deficits in several southern EU countries. In the same period, euro area GDP rose by 1.0 percent from the first three months of the year. Particularly strong growth in Germany (+2.2 percent) stimulated activity also in the neighbouring countries such as Austria, whereas the highly-indebted southern euro area economies remained in stagnation.

At the same time, some withdrawal of fiscal and monetary expansion has moderated the pace of activity in the emerging economies in Asia. While the outlook is for continued firm growth in the region, decelerating import demand will weigh on prospects for the US economy, since private consumption in the USA is set to advance only gradually in the aftermath of the financial market crisis and with unemployment staying high.

For the euro area and the Central and Eastern European countries, leading indicators suggest GDP growth for the second half of 2010 still exceeding the long-term average. With the stimulus from currency depreciation fading, the pace of exports may decelerate in the months to come. Yet, higher capacity utilisation and improved corporate earnings should revive business fixed investment, rendering a relapse of the economy into recession increasingly unlikely.

Nevertheless, the upswing in the euro area is likely to stay moderate in 2011, on account of slower export growth on the one hand, and of the impact of the imminent fiscal consolidation on private demand on the other. This holds particularly for those euro area countries which struggle with low competitiveness and the after-effects of earlier real estate price bubbles. High public sector deficits in these countries and major macroeconomic imbalances in the euro area still pose considerable risks. In Germany and its neighbours, the recovery will therefore be stronger than in the southern part of the euro area.

For Austria, WIFO expects real GDP growth of 2.0 percent in 2010 and 1.9 percent in 2011. The recovery is primarily driven by exports of goods, expected to gain 12.0 percent and 7.3 percent, respectively, thereby returning to their level of 2008 towards the end of 2011. On the back of the favourable export outlook, domestic demand can be expected to pick up. Investment in machinery and equipment will stabilise, but construction activity is likely to remain sluggish over the entire forecast period. With the general business situation improving, private consumption will maintain its steady upward trend. While modest increases in real earnings and the planned fiscal consolidation measures will allow only small gains in real disposable income over both years, households should find scope for higher consumption by lowering their saving from 11.0 percent in 2009 to a projected 10.5 percent of disposable income by 2011.

Table 1: Main results

		2006	2007	2008	2009	2010	2011
		Percentage changes from previous year					
GDP							
Volume		+ 3.6	+ 3.7	+ 2.2	- 3.9	+ 2.0	+ 1.9
Value		+ 5.5	+ 5.9	+ 4.1	- 3.1	+ 3.0	+ 3.7
Manufacturing ¹ , volume		+ 8.2	+ 8.5	+ 3.5	- 14.0	+ 7.0	+ 5.5
Wholesale and retail trade, volume		+ 2.1	+ 2.0	+ 0.9	- 1.4	+ 1.8	+ 0.8
Private consumption expenditure, volume		+ 1.8	+ 0.7	+ 0.5	+ 1.3	+ 1.1	+ 0.8
Gross fixed investment, volume		+ 1.8	+ 3.9	+ 4.1	- 8.8	- 2.5	+ 2.4
Machinery and equipment		+ 1.8	+ 6.6	+ 7.5	- 14.5	- 2.0	+ 4.0
Construction		+ 0.7	+ 1.6	+ 1.6	- 6.0	- 3.0	+ 1.0
Exports of goods²							
Volume		+ 6.1	+ 9.0	+ 0.3	- 18.7	+ 12.0	+ 7.3
Value		+ 9.5	+ 10.5	+ 2.5	- 20.2	+ 14.8	+ 8.8
Imports of goods²							
Volume		+ 4.3	+ 7.6	+ 0.2	- 15.1	+ 8.6	+ 6.0
Value		+ 8.0	+ 9.6	+ 4.7	- 18.4	+ 13.3	+ 7.2
Current balance	billion €	+ 7.26	+ 9.62	+ 9.24	+ 6.32	+ 7.64	+ 9.62
As a percentage of GDP		+ 2.8	+ 3.5	+ 3.3	+ 2.3	+ 2.7	+ 3.3
Long-term interest rate ³	in percent	3.8	4.3	4.4	3.9	3.1	2.9
Consumer prices		+ 1.5	+ 2.2	+ 3.2	+ 0.5	+ 1.8	+ 2.1
Unemployment rate							
Eurostat definition ⁴	in percent	4.8	4.4	3.8	4.8	4.4	4.3
National definition ⁵	in percent	6.8	6.2	5.8	7.2	6.9	6.8
Persons in active dependent employment ⁶		+ 1.7	+ 2.1	+ 2.4	- 1.4	+ 0.8	+ 0.6
General government financial balance according to Maastricht definition							
As a percentage of GDP		- 1.5	- 0.4	- 0.4	- 3.5	- 4.1	- 3.5

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.

Owing to the recovery and lower interest payments, the general government deficit for 2010, at a projected 4.1 percent of GDP, will turn out somewhat smaller than anticipated in spring. For 2011, the federal government envisages consolidation measures totalling € 3.4 billion or 1.3 percent of GDP, 60 percent of which to be achieved through expenditure cuts. In addition, the Länder are expected to contribute € 0.8 billion to deficit reduction. In this way, the general government deficit should narrow to 3.5 percent of GDP in 2011. However, since specific measures have not yet been disclosed, the projections are based on preliminary technical assumptions on the design of the consolidation strategy.

The projections see the number of persons in dependent active employment moving up by 0.8 percent and 0.6 percent, respectively, in 2010 and 2011¹. As labour supply will increase at the same time, the unemployment rate will edge down only marginally. Employment has risen primarily in services with a high share of part-time workers, whereas the fall in the number of manufacturing jobs has only recently come to a halt.

Employees' net real earnings per capita (deflated by the CPI) will decrease both in 2010 and 2011, by 0.9 percent and 0.2 percent, respectively. Apart from moderate wage settlements, this is due to a pick-up in inflation, driven in 2010 by rising oil prices. Underlying the projection for 2011 is the technical assumption that the increase in taxes and public charges with a view to fiscal consolidation will add 0.4 percentage points to headline inflation. Even though capacity utilisation and cost pressures will remain moderate, the rate of inflation (national CPI) will therefore ratchet up to 1.8 percent in 2010 and 2.1 percent in 2011.

From high rates above 5 percent since the third quarter of 2009, world trade growth eased to around 3½ percent in the second quarter of 2010, compared with the previous period, still exceeding the average for the last ten years. World trade volumes and global industrial output have thus almost returned to levels attained before the crisis.

The latest deceleration reflects the advanced stage of inventory build-up and some moderation of the boom in Asia. After a sharp rundown of stocks in early 2009, the turnaround in stockbuilding with the onset of recovery in autumn 2009 stimulated trade in semi-finished goods. Both in the USA and in the euro area, the change in inventories between the third quarter 2009 and the first quarter 2010 accounts for a large part of GDP growth. This process has by now been almost completed and inventory-to-output ratios are back within their normal range. Over the projection period, the growth contribution of stockbuilding in the industrialised economies will thus be smaller, but still positive.

World trade growth abating somewhat

After a strong rebound since autumn 2009, the volume of global trade has almost regained its pre-crisis level. In the second quarter 2010, the momentum slowed somewhat, as inventories in the industrialised countries have been largely replenished and growth in Asia has decelerated slightly, while still remaining buoyant.

Table 2: World economy

	2006	2007	2008	2009	2010	2011
	Percentage changes from previous year					
<i>Real GDP</i>						
World	+ 5.2	+ 5.2	+ 2.9	- 1.0	+ 4.0	+ 3.5
USA	+ 2.7	+ 1.9	± 0.0	- 2.6	+ 2.7	+ 2.0
Japan	+ 2.0	+ 2.4	- 1.2	- 5.2	+ 2.6	+ 1.4
EU 27	+ 3.2	+ 3.0	+ 0.5	- 4.2	+ 1.8	+ 1.8
Euro area 16	+ 3.0	+ 2.9	+ 0.5	- 4.1	+ 1.8	+ 1.7
Germany	+ 3.4	+ 2.7	+ 1.0	- 4.7	+ 3.2	+ 2.2
New EU countries ¹	+ 6.5	+ 6.0	+ 3.8	- 3.0	+ 1.5	+ 2.5
China	+ 11.6	+ 13.0	+ 9.7	+ 8.7	+ 10.0	+ 8.0
World trade, volume	+ 8.9	+ 7.1	+ 2.2	- 12.8	+ 18.8	+ 8.0
Market growth ²	+ 10.6	+ 7.1	+ 3.3	- 13.0	+ 11.5	+ 6.5
<i>Primary commodity prices</i>						
HWI index, total	+ 19.7	+ 3.7	+ 22.4	- 29.2	+ 32.0	+ 1.0
Excluding energy	+ 22.0	+ 9.5	+ 15.6	- 22.7	+ 37.0	+ 1.0
<i>Crude oil prices</i>						
Brent, \$ per barrel	65.1	72.5	97.0	61.5	76.0	80.0
<i>Exchange rate</i>						
\$ per euro	1.256	1.371	1.471	1.393	1.30	1.35

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

¹ With the employment statistics collected by the Social Insurance Agency likely to be revised in 2011, figures for 2009 and 2010 may be revised ex post.

The second key factor for the rebound of world trade since autumn 2009 has been strong demand from Asia. Indeed, with import volume growth exceeding 10 percent in the fourth quarter 2009 and in early 2010, it acted as a major driver of the global recovery. In the second quarter, import and industrial output growth slackened noticeably. In China, after the massive fiscal stimulus provided in 2009, fears of cyclical overheating arose. The dampening action from monetary policy are about to show early effects. Growth in Asia nevertheless promises to stay robust, even after fiscal stimulus in China has ebbed. WIFO expects Chinese real GDP to expand by 10 percent in 2010 and 8 percent in 2011.

In the second quarter 2010, activity in the USA gained 0.4 percent from the previous period, distinctly less than in the three earlier periods. Main reasons were a lower contribution from stockbuilding, slackening export growth and higher imports, while other demand components were broadly stable. Machinery and equipment investment expanded for the second consecutive quarter, and also private consumption proved resilient (+0.5 percent).

The slowdown gave rise to some fears that the economy might relapse into recession. Latest data rather point to a flatter trend, but still remaining upward bound. Lower import demand from Asia, weakening price competitiveness vis-à-vis the euro and the fading of fiscal stimulus will in any case weigh on aggregate demand.

A further reason for a less benign outlook is the absence of improvement on the labour market. Employment has been virtually flat for the last 12 months, with unemployment stuck at a rate of 9.6 percent. This and the high indebtedness of private households act as a drag on consumption. Households' efforts to reduce their debt burden are mirrored by the increase in the saving ratio from 2.1 percent in 2007 to 6.1 percent in spring 2010. How far the upward correction will go is still unclear. Although house prices have stabilised, the still high number of foreclosures point to the persistent tensions on real estate markets.

Still, the recovery should continue also without further fiscal stimulus. WIFO expects real US GDP to expand by 2.7 percent in 2010 and 2.0 percent in 2011. Monetary and fiscal policy has been in a wait-and-see mode over the last months. The US general government deficit rose to 11.0 percent of GDP in 2009, with the public debt ratio of 83.0 percent of GDP now broadly matching that of the euro area.

Euro area GDP advanced by 1.0 percent in the second quarter from the previous period. With some lag vis-à-vis the USA, industrial activity picked up and should approach average levels of capacity utilisation by the end of the year. Somewhat paradoxically, the upswing was triggered by the crisis in spring 2010 that led to a substantial decline in the euro exchange rate, thereby stimulating exports. Together with buoyant demand for capital goods, the fall in the effective exchange rate by some 10 percent has probably led to substantial gains in market shares, notably in Asia. Thus, German exports to China in the first half of 2010 were more than 50 percent above the year-earlier level.

The exceptionally strong pace of economic growth in Germany of +2.2 percent in the second quarter is only partly explained by one-off factors. In view of the booming exports, industrial confidence and consumer sentiment are currently high, thereby providing positive incentives also for domestic demand. Private consumption, after a steady decline from mid-2009, picked up by 0.6 percent in the second quarter, and also gross fixed investment is heading up since early 2010.

The economies of Germany's neighbours have been pulled upward on account of close trade linkages. However, in most southern euro area countries (Spain, Portugal, Italy) activity remained subdued and contracted further in Greece.

Exchange rate changes usually impact with a certain lag on business activity. The export boom in the euro area should therefore continue into autumn. Accordingly, leading indicators point to above-average GDP growth for the third quarter, albeit down from the rate observed in the previous period. Thereafter and in 2011, export

Recovery in the USA progressing at somewhat slower pace

With the replenishment of stocks levelling off and slower export growth, the recovery of the US economy shifted into lower gear in the second quarter 2010. In view of high unemployment and the after-effects of the financial market crisis, domestic demand will expand only gradually in 2011, while economic policy has adopted a wait-and-see attitude.

Upswing in the euro area subject to lasting risks

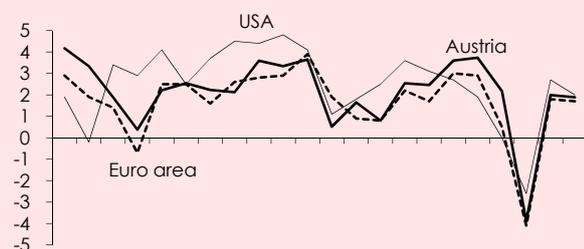
Benefiting from euro depreciation, euro area exports should increase further in the latter part of the year, but lose momentum in 2011. With the recovery of industrial activity, internal demand should also pick up. However, high government deficits and economic imbalances within the euro area are lasting risks for business activity.

growth should moderate as the impact of a weaker euro fades and global economic growth shifts into lower gear.

Figure 1: Indicators of economic performance

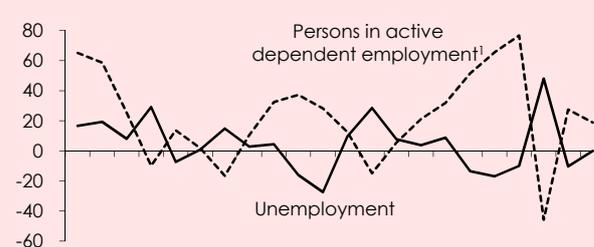
Growth of real GDP

Percent



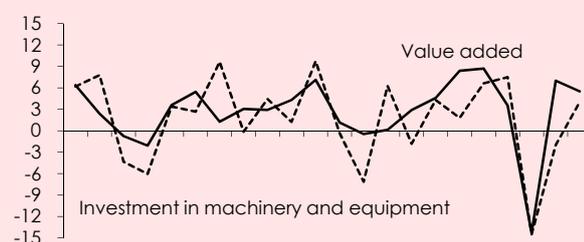
Employment and unemployment

1,000 from previous year



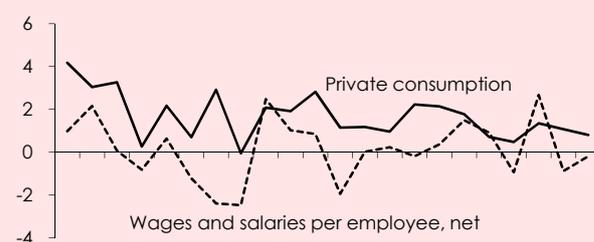
Manufacturing and investment

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



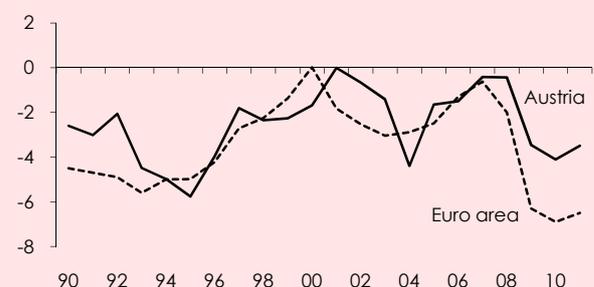
Trade

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).

By the end of 2010, the euro area manufacturing sector should have made up the losses from the crisis, with capacity utilisation and earnings ratio converging towards their long-term average. Corporate finances will thus become less vulnerable to short-term demand variations. After almost two years of stagnation, parts of the

capital stock need to be replaced, putting an end to the fall in machinery and equipment investment. The danger of a relapse into recession has thereby diminished.

With the improvement in current business conditions, internal demand in the euro area should strengthen further. However, the most recent forecasts for 2011 remain cautious.

Such caution is rooted not only in the deceleration of world trade, but also in the strain of government budgets and the competitive imbalances within the euro area. The member countries' stability programmes foresee fiscal savings in the amount of 1.1 percent of GDP for the entire euro area. This amount is, however not distributed evenly: the crisis of last May forced the Mediterranean deficit countries to take early consolidation measures which will hold back GDP growth in 2010 and 2011 in these countries. The impact of these measures on other euro area countries should, however, remain limited². In the other countries, budgetary cuts will turn out only moderate, according to present information. Germany, for instance, plans for 2011 savings equivalent to around 0.5 percent of GDP.

Because of the persistently wide interest rate differentials for government bonds of the southern countries, uncertainty about their debt situation remains. These economies also suffer from losses of competitiveness that have accumulated over the last ten years, and of the high current account deficits requiring further adjustment in the years to come.

The cyclical recovery in the euro area therefore is likely to be uneven. Overall, WIFO expects GDP to expand by 1.8 percent in 2010 and 1.7 percent in 2011. However, due to a large carry-over from 2010, the annual rate of 1.7 percent for 2011 implies a clearly below-average growth momentum during the year³. In Germany, growth will be stronger in both years (projected at +3.2 percent and +2.2 percent, respectively). Headline inflation in the euro area will rise from 0.3 percent in 2009 to some 1½ percent in 2010 due to the depreciation of the euro, whose lagged effects, together with various tax increases, may give rise to some further increase in 2011. Employment is expected to continue its downward trend in 2010, before bottoming out in 2011.

Prospects for the countries in Central and Eastern Europe are also rather uneven. The economies with close trade links to German manufacturing industry are likely to recover more quickly than those of the more southern area with high foreign debt. Overall, WIFO expects for the eight new EU countries in east-central Europe GDP growth of 1.5 percent in 2010 and 2.5 percent in 2011.

Poland's economy has resisted best to the crisis in 2009 and may grow by almost 3 percent in the current year. Also the Czech Republic and Slovakia posted substantial gains in the second quarter, with annual growth rates projected at around 2 percent and 4 percent, respectively. Countries with high external debt of private households (Hungary, Romania, Bulgaria, the Baltic countries) may suffer a further setback of domestic demand in 2010, bottoming out only in 2011. In these countries, the high level of interest rates and poor competitiveness weigh on the pick-up of economic activity. In order to prevent a spill-over of the debt crisis from the euro area, some of the countries have taken measures of fiscal consolidation in the last few months.

Developments in Central and Eastern European countries uneven

² This is confirmed by model simulations, given that the share of the southern euro area countries in German or French exports is small. Half of the large euro area countries' exports go to non-EU countries (Rünstler, G., "Euro Area Economy Drawing Lagged Benefits from Currency Depreciation and Buoyant Global Trade. Economic Outlook for 2010 and 2011", Austrian Economic Quarterly, 2010, 15(3), p. 245-258, http://www.wifo.ac.at/www/jsp/index.jsp?fid=23923&id=40288&typeid=8&display_mode=2).

³ The growth carry-over defines the impact of the momentum within a certain year on the annual growth rate in the subsequent year: in 2010, the strong expansion of the second and third quarter yields a substantial growth contribution for 2011. An annual growth rate of 1.7 percent can therefore be achieved with average quarter-on-quarter gains of only 0.2 to 0.3 percent during 2011.

Also in other south-eastern European countries and in the CIS, economic activity is set to advance at a moderate pace.

With the strong rebound of business activity in Europe, notably in Germany, merchandise exports jumped by 6.4 percent in the second quarter from the previous period. Nevertheless, in the second half of the year the momentum is set to slow down. For the whole year 2010, the assumptions on the external environment yield a growth rate of 11.5 percent for Austria's export markets, followed by a still solid increase of 6.5 percent for 2011. In both years, exports will somewhat exceed market growth, with projected real growth rates of 12.0 percent and 7.3 percent, respectively. Not only deliveries to the euro area, but also those to neighbouring CEECs (Czech Republic, Slovakia, Slovenia, Hungary) should develop favourably. Growth of merchandise imports, projected at 8.6 percent for 2010 and 6.0 percent for 2011, will be less dynamic than that of exports.

Due to the lively foreign demand for Austrian goods, net exports including services will provide a sizeable contribution to GDP growth of 1.4 percentage points in 2010, and a somewhat lower 0.8 percentage points in 2011.

Since the currencies of the CEECs largely followed the depreciation of the euro, the nominal-effective exchange rate for Austrian manufactures may edge down in 2010 by only 0.7 percent from last year, with the direct effect of euro depreciation being small. Export prices will increase only moderately in both years (+2.5 percent in 2010 and +1.4 percent in 2011). Import prices of crude oil and other raw materials go up significantly in 2010 as a result of the fall of the euro against the dollar. Yet, the depreciation will hardly affect prices of other imported goods, resulting in an overall import price increase of 4.3 percent in 2010 and of 1.1 percent in 2011. The trade balance will improve in both years.

Higher tax revenues on the back of the revival of business activity and low interest expenditure will rein back the general government deficit for 2010 to 4.1 percent of GDP, some ½ percentage point down from the Spring forecast.

For 2011, the federal government envisages fiscal consolidation measures totalling € 3.4 billion or 1.3 percent of GDP. In addition, the Länder will be asked to contribute € 0.6 billion to deficit reduction. On these assumptions, WIFO projects the general government deficit to narrow to 3.5 percent of GDP in 2011. Rising employment and low government bond yields will support the consolidation efforts.

Austria: goods exports driving the recovery

The WIFO projection for Austria is for GDP growth of 2.0 percent in 2010 and 1.9 percent in 2011. Exports of goods to other euro area countries and to neighbouring CEECs will remain buoyant.

Fiscal consolidation in 2011

The fiscal consolidation measures, in conjunction with the cyclical recovery, will reduce the general government deficit from 4.1 percent of GDP in 2010 to 3.5 percent in 2011.

Table 3: Key policy indicators

	2006	2007	2008	2009	2010	2011
	As a percentage of GDP					
<i>Fiscal policy</i>						
General government financial balance						
According to Maastricht definition	- 1.5	- 0.4	- 0.4	- 3.5	- 4.1	- 3.5
According to National Accounts	- 1.6	- 0.5	- 0.5	- 3.5	- 4.1	- 3.5
General government primary balance	+ 1.2	+ 2.3	+ 2.1	- 0.7	- 1.4	- 0.7
	In percent					
<i>Monetary policy</i>						
3-month interest rate	3.1	4.3	4.6	1.2	0.8	1.0
Long-term interest rate ¹	3.8	4.3	4.4	3.9	3.1	2.9
	Percentage changes from previous year					
<i>Effective exchange rate</i>						
Nominal	+ 0.2	+ 1.1	+ 1.2	+ 0.9	- 0.7	+ 0.7
Real	- 0.5	+ 0.7	+ 0.6	+ 0.4	- 0.8	+ 0.9

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

Details of the fiscal plans have not yet been disclosed. About 40 percent of the consolidation amount is to be achieved via tax increases. The WIFO projection is based on the technical assumption that higher revenues will be generated to equal shares by indirect (e.g., on energy) and direct taxes. The planned expenditure restraint has

been tentatively allocated to government purchases of inputs, personnel cost, monetary social transfers and investment outlays.

For 2010 and 2011, WIFO expects consumer prices to move up by 1.8 percent and 2.1 percent, respectively. Because of falling oil prices, headline inflation was untypically low in 2009, at 0.5 percent. With oil prices bouncing back to around \$ 76 per barrel, this effect is being reversed in 2010. The harmonised inflation rate excluding energy and unprocessed food will, however, edge down from 1.5 percent in 2009 to 1.3 percent in 2010 under the impact of only small hikes in unit labour cost and still below-average capacity utilisation.

For 2011, the technical assumption relating to fiscal consolidation implies a boost to headline inflation of 0.4 percentage points via higher indirect taxes and public charges, pushing the annual inflation rate to 2.1 percent. Upward pressure will still be limited, as the effect of higher energy prices and tax increases will remain transitory as long as the momentum of business activity remains moderate. It is only with higher capacity utilisation and accelerating unit labour cost increases that inflation would ratchet up permanently. Both phenomena are usually observed only at an advanced stage of a cyclical upswing.

Inflation heading up to 2 percent in 2011

Driven by higher energy cost, headline inflation will edge up to 1.8 percent in 2010. Hikes of indirect taxes may temporarily raise inflation further, while moderate growth prospects should keep upward price pressure under control.

Table 4: Productivity

	2006	2007	2008	2009	2010	2011
	Percentage changes from previous year					
<i>Total economy</i>						
Real GDP	+ 3.6	+ 3.7	+ 2.2	- 3.9	+ 2.0	+ 1.9
Employment ¹	+ 1.5	+ 1.7	+ 2.2	- 0.8	+ 0.9	+ 0.7
Productivity (GDP per employment)	+ 2.1	+ 2.0	- 0.0	- 3.1	+ 1.1	+ 1.2
<i>Manufacturing</i>						
Production ²	+ 8.4	+ 8.7	+ 3.5	- 14.3	+ 7.0	+ 5.5
Employees ³	+ 0.2	+ 2.6	+ 1.7	- 6.0	- 1.2	+ 1.2
Productivity per hour	+ 8.0	+ 6.3	+ 2.3	- 5.4	+ 4.8	+ 4.2
Working hours per day per employee ⁴	+ 0.2	- 0.3	- 0.5	- 3.6	+ 3.3	- 0.0

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.

Despite an increase during the year, gross fixed investment will recede by another 2.5 percent on annual average 2010, because of the negative carry-over from last year and a weak first quarter. For 2011, WIFO expects a gain of 2.4 percent.

Investment in machinery and equipment is particularly volatile over the business cycle, as it primarily depends on firms' sales expectations in relation to spare productive capacity. In 2009, it dropped by 14.5 percent in volume from the previous year. In the second quarter 2010, the lower turning point may have been reached, when corporate capital spending rose by a seasonally-adjusted 5.3 percent quarter-on-quarter, the first increase in two years. With the cyclical revival of the second quarter, capacity utilisation improved markedly and should approach its long-term average by the end of the year. Industrial output in July matched the level held in 2006, 11 percent below the peak of January 2008. As the business situation returns to normal, financing conditions should gradually improve. Finally, towards the end of the year, investment plans may be carried forward in view of the expiry of tax subsidies.

Thus, machinery and equipment investment should continue its upward trend in the quarters to come. For the whole year 2010, it will still fall by 2.0 percent in volume, followed by a gain of 4.0 percent in 2011.

Construction activity continued its adverse trend in the first half of 2010. Although early signs of stabilisation have been observed, net output is likely to fall by a further 3.0 percent in 2010, before heading up slightly (+1.0 percent) in 2011. The building sector may expand next year if the cyclical recovery is sustained, although residential construction is set to remain sluggish, as witnessed by the shrinking number of building permits issued. Even worse is the outlook for civil engineering: after benefiting from fiscal stimulus in 2010, the latter is about to expire and private demand is

Sluggish construction activity

With the economic recovery, investment in machinery and equipment will rebound. In the construction industry, however, the adverse trend is set to continue.

lacking. As from 2011, civil engineering could be negatively affected by cuts in public spending.

In 2010 and 2011, projected real disposable income growth of 0.8 percent and 0.6 percent will markedly lag behind GDP growth. While this corresponds to the usual pattern in an early cyclical upswing, it is also due to the reversal of two factors supporting real income during the economic crisis: in 2009, the surprisingly low inflation rate of 0.5 percent implied a substantial gain in real earnings which, in addition, were boosted by the income tax reform. For 2010 and 2011, the projection is for a slight decline in net real per-capita earnings, and fiscal policy will turn towards restraint. The impact of consolidation on private disposable income in 2011 will depend on the design of the fiscal measures envisaged, which creates an element of uncertainty for the income projection for 2011.

In any case, private households have sufficient scope for offsetting weaker income growth by reduced saving, as has been the case in previous consolidation periods. The better cyclical outlook will also strengthen household sentiment. In the last months, consumer confidence has climbed markedly, while retail sales and new car registrations headed up.

Stable private consumption despite sluggish income growth

Real disposable income will rise only moderately in 2010 and 2011, but private household demand should prove robust. The still unknown details of the fiscal consolidation programme create an element of uncertainty for the consumption outlook for 2011.

Table 5: Private consumption, income and prices

	2006	2007	2008	2009	2010	2011
	Percentage changes from previous year					
Private consumption expenditure	+ 1.8	+ 0.7	+ 0.5	+ 1.3	+ 1.1	+ 0.8
Durables	+ 5.9	+ 2.6	+ 1.7	+ 5.2	- 1.0	- 0.3
Non-durables and services	+ 1.3	+ 0.5	+ 0.3	+ 1.0	+ 1.3	+ 0.9
Household disposable income	+ 3.0	+ 1.7	+ 1.8	+ 0.8	+ 0.8	+ 0.6
	As a percentage of disposable income					
Household saving ratio ¹	10.8	11.3	12.0	11.0	10.7	10.5
Household saving ratio ²	10.2	11.0	11.8	10.5	10.3	10.1
	Percentage changes from previous year					
Direct lending to domestic non-banks ³	+ 4.5	+ 3.6	+ 7.4	- 1.3	+ 2.9	+ 4.1
	Percentage changes from previous year					
Inflation rate						
National	1.5	2.2	3.2	0.5	1.8	2.1
Harmonised	1.7	2.2	3.2	0.4	1.8	2.1
Core inflation ⁴	1.3	1.9	2.4	1.5	1.3	1.6

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 6: Earnings and international competitiveness

	2006	2007	2008	2009	2010	2011
	Percentage changes from previous year					
Gross earnings per employee ¹	+ 3.2	+ 3.1	+ 2.9	+ 1.5	+ 1.2	+ 2.2
Gross real earnings per employee ²	+ 1.7	+ 0.9	- 0.3	+ 1.0	- 0.6	+ 0.1
Net real earnings per employee ²	+ 1.5	+ 0.9	- 0.9	+ 2.7	- 0.9	- 0.2
<i>Total economy</i>						
Unit labour costs	+ 0.9	+ 0.9	+ 2.7	+ 4.8	+ 0.3	+ 1.0
<i>Manufacturing</i>						
Unit labour costs	- 3.4	- 2.3	+ 1.1	+13.5	- 6.2	- 1.7
Effective exchange rate, manufactures						
Nominal	+ 0.2	+ 1.2	+ 1.1	+ 0.7	- 0.7	+ 0.7
Real	- 0.4	+ 0.8	+ 0.6	+ 0.3	- 0.7	+ 0.9

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

WIFO expects private consumption to gain 1.1 percent in 2010 and 0.8 percent in 2011. In line with previous experience, the household saving ratio is projected to abate from 11.0 percent in 2009 to 10.5 percent by 2011.

The favourable trend in private consumption is mirrored by retail trade data. After last year's losses, the situation is becoming substantially better this year. Net output (value added) should expand by an inflation-adjusted 1.8 percent in 2010, also owing to wholesale trade which benefits from lively exports and industrial activity. In 2011, trade sector output is set to expand at a somewhat slower pace, by 0.8 percent.

Labour market developments have surprised on the upside in recent months. After a fall by 1.4 percent in 2009, the number of persons in dependent active employment has been up year-on-year since March. In August, employment as recorded by the social security administration was 51,500 or 1.6 percent higher than one year ago.

The positive trend is partly explained by lively job creation in quasi-public services (ÖNACE categories O to Q, where employment exceeded the year-earlier level by 28,700 or 3.5 percent in August). Hiring was strongest for jobs in "education and teaching" and "social services". In other service branches, employment in August was slightly up from last year.

In addition, manufacturing jobs were sustained during the crisis through flexible work hours arrangements and wage moderation. Their total number was 2,200 or 0.4 percent higher in August than one year ago. At the same time, an increase in temporary work can be observed (+20,000 year-on-year in August 2010), which is increasingly used as a means to accommodate capacity shortages.

Benign employment trend to continue

Employment will increase by 0.8 percent in 2010 and by 0.6 percent in 2011. The unemployment rate will edge down slightly next year.

Table 7: Labour market

		2006	2007	2008	2009	2010	2011
		Changes from previous year, in 1,000					
<i>Demand for labour</i>							
Persons in active employment ¹		+ 56.1	+ 68.6	+ 84.2	- 39.6	+ 33.4	+ 25.5
Employees ²		+ 51.5	+ 65.5	+ 76.7	- 45.8	+ 27.4	+ 18.8
Percentage changes from previous year		+ 1.7	+ 2.1	+ 2.4	- 1.4	+ 0.8	+ 0.6
Nationals		+ 35.0	+ 43.6	+ 53.2	- 40.3	+ 17.4	+ 8.8
Foreign workers		+ 16.5	+ 21.9	+ 23.5	- 5.6	+ 10.0	+ 10.0
Self-employed ³		+ 4.6	+ 3.1	+ 7.5	+ 6.2	+ 6.0	+ 6.7
<i>Labour supply</i>							
Population of working age	15 to 64 years	+ 12.8	+ 15.5	+ 27.7	+ 17.3	+ 26.3	+ 30.6
	15 to 59 years	+ 47.3	+ 17.1	+ 17.6	+ 11.1	+ 12.3	+ 15.9
Labour force ⁴		+ 42.6	+ 51.7	+ 74.2	+ 8.4	+ 23.1	+ 25.5
<i>Surplus of labour</i>							
Registered unemployed ⁵		- 13.5	- 16.9	- 10.0	+ 48.1	- 10.3	± 0.0
In 1,000		239.2	222.2	212.3	260.3	250.0	250.0
Unemployed persons in training ⁵		in 1,000	57.5	52.7	50.5	64.1	73.7
							69.0
In percent							
Unemployment rate							
Eurostat definition ⁶		4.8	4.4	3.8	4.8	4.4	4.3
As a percentage of total labour force ⁵		6.1	5.6	5.2	6.4	6.1	6.1
National definition ^{5,7}		6.8	6.2	5.8	7.2	6.9	6.8
Employment rate							
Persons in active employment ^{1,8}		63.9	64.9	66.1	65.2	65.5	65.6
Total employment ^{6,8}		70.2	71.4	72.1	71.6	71.7	71.9

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, without self-employed. – ⁸ As a percentage of population of working age (15 to 64 years).

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.

Carry-over (in economic growth)

The carry-over identifies the impact of the dynamics of a series (in seasonally adjusted figures) during one year (t_0) on the annual percentage change in the following year (t_1). It is defined as the annual percentage change in year t_1 , if GDP in t_1 remains constant at the level of the fourth quarter of year t_0 (in seasonally adjusted terms).

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/>).

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.ikt.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".

However, the employment records of the social security agencies are not free of distortions. It is planned that as from 2011 the data will be collected on a central and time-consistent basis, following which the entire employment statistics is to be recal-

culated starting from January 2008. This may give rise to ex-post changes of employment growth rates⁴.

On the basis of the data available, WIFO projects the number of persons in dependent active employment to rise by 0.8 percent and 0.6 percent in 2010 and 2011, respectively. The unemployment rate, on conventional national definitions, will decline from 7.2 percent in 2009 to 6.8 percent by 2011. Having stagnated in 2009, labour supply (as measured by the labour force) will resume growing over the forecast period, albeit substantially less than in the years before. Moreover, the number of persons enrolled in job training programmes is likely to diminish.

Many of the newly-created jobs in the service sector are part-time jobs with rather low productivity. This explains not only the fall in the average weekly work hours for the entire economy, but also to some extent the relatively strong employment increase accompanied by sluggish productivity growth (measured as GDP per employment contract). The projection assumes that this trend will continue at a slower pace in 2011.

Productivity developments will also shape wage formation. For the economy as a whole, WIFO expects nominal gross wages per capita to edge up by a moderate 1.2 percent in 2010 and 2.2 percent in 2011. This implies a slight decline in net real per capita wages (deflated by the consumer price index) by 0.9 percent in 2010 and 0.2 percent in 2011⁵.

Although export earnings from tourism services dropped markedly in 2009, Austria gained international market shares because of its attractiveness for short-distance travellers.

2010 may see a further slight reduction in foreign visitors' spending in Austria (–1 percent in volume). Export earnings would thereby abate to the level attained in 2007. In both years, net earnings remain stable around € 6½ billion. The fall in demand from abroad and restrained spending on the part of domestic holidaymakers are mirrored by further slight output (value added) losses for the hotel and restaurant sector (–0.5 percent; in 2009 –2.5 percent in volume from the previous year). In 2011, output is expected to pick up by 0.9 percent.

Due to buoyant goods exports, the current account surplus in 2011 will approach the record highs of 2007 and 2008. WIFO expects for 2011 a surplus equivalent to 3.3 percent of GDP.

Lacklustre demand for tourism services

⁴ Parts of such distortions have already been corrected as from mid-2010, resulting in slight changes in year-on-year employment growth rates.

⁵ In 2009, an unusually wide discrepancy opened up between the consumption deflator according to national accounts on the one hand, and the consumer price index (CPI) on the other. This is explained by a special development in the area of imputed bank services which lowered the consumption deflator. In these circumstances, the CPI is the better measure for the trend in living cost.