Stefan Ederer

Upswing with Stronger Momentum, but Subject to Higher Risks

Economic Outlook for 2011 and 2012

The cyclical upswing in Austria continues. Driven by the swift expansion of global activity, exports are posting strong gains. Meanwhile, the momentum is being transmitted to private investment which is set to rise substantially over the forecast period. Short-term indicators suggest that the positive trend will persist in the first half of 2011 before moderating somewhat in parallel with developments abroad, under the impact of rising commodity and energy prices and a more restrictive policy stance in both the industrialised and the emerging economies. Further ahead, demand and output growth is set to regain momentum. For Austria, WIFO expects GDP to increase by 2.5 percent in 2011 and 2.0 percent in 2012. The major risk for the upswing currently derives from the drift in commodity and energy prices which may have a substantial impact on the world economy.

All staff members of the Austrian Institute of Economic Research contribute to the Economic Outlook. Data processing: Nora Popp, Roswitha Übl • Cut-off date: 30 March 2011. • E-mail address: Stefan.Ederer@wifo.ac.at

Growth of the world economy accelerated markedly towards the end of 2010. After a period of stagnation, world trade posted substantial gains. Notably the emerging economies in Asia raised their imports significantly, thereby providing the major impetus for the expansion of demand and output worldwide. Although policy in China and other developing countries tries to avoid cyclical overheating and while rising commodity and energy prices may dampen economic activity, the developing Asian economies will continue to provide important incentives for growth of the world economy. Economies in Latin America, for their part, benefit notably from higher prices for food and other raw materials and should also enjoy lively growth. However, strong capital inflows have recently driven up their exchange rates, weighing on exports and adding to risks of financial market turbulence. Overall, world economic growth should stay robust in the first half of 2011. Thereafter, the pace should moderate somewhat under the impact of rising commodity and energy prices and a more restrictive policy stance in many countries. In 2012, global demand and output growth is set to regain momentum.

In the USA, growth is surprisingly strong. Overall demand is driven by exports, investment and expenditure on durable consumer goods. The persistent weakness of the dollar and the sustained expansionary stance of monetary and fiscal policy are supportive to domestic activity. Weak spots are the real estate market and high indebtedness of both the private and the public sector, whereas the improvement on the labour market should provide positive impulses.

The euro area economy is expected to expand only at a moderate pace up to the forecast horizon. Also, the gap between countries enjoying buoyant growth and those caught in crisis and stagnation will become still wider. Germany and countries with close links to the German economy will continue to benefit from the international upturn. Ireland and several countries in southern Europe will, however, remain in recession, which dampens the prospects for the EU overall.

The Austrian economy will continue its cyclical upswing. Lively activity in Germany gave strong impetus to Austrian exports in 2010. In this way, Austrian manufacturing industry benefited indirectly from the booming emerging market economies. At the same time, the pick-up of investment in machinery and equipment over the last three quarters indicates that the stimulus from exports is being transmitted to domestic capital formation. This trend is likely to persist, as cyclical indicators suggest strong economic growth for the first half of 2011. In the latter part of the year, the expansion should lose some momentum, in parallel to the international cyclical profile. For the whole year 2011, WIFO expects GDP growth at 2.5 percent, followed by an annual average of 2 percent in 2012.

Table 1: Main results

		2007	2008	2009	2010	2011	2012
		Percentage changes from previous year					
GDP							
Volume		+ 3.7	+ 2.2	– 3.9	+ 2.0	+ 2.5	+ 2.0
Value		+ 5.9	+ 4.1	– 3.1	+ 3.5	+ 4.5	+ 4.1
Manufacturing[1], volume		+ 8.5	+ 3.5	– 14.0	+ 6.6	+ 7.0	+ 5.5
Wholesale and retail trade, volume		+ 2.0	+ 0.9	– 1.4	+ 2.8	+ 1.3	+ 1.1
Private consumption expenditure, volume		+ 0.7	+ 0.5	+ 1.3	+ 1.0	+ 1.1	+ 1.1
Gross fixed investment, volume		+ 3.9	+ 4.1	– 8.8	– 1.3	+ 2.6	+ 2.7
Machinery and equipment		+ 6.6	+ 7.5	– 14.5	+ 1.8	+ 5.5	+ 4.5
Construction		+ 1.6	+ 1.6	– 6.0	– 3.4	± 0.0	+ 1.0
Exports of goods[2]							
Volume		+ 9.0	+ 0.3	– 18.7	+ 12.7	+ 8.8	+ 8.0
Value		+ 10.5	+ 2.5	– 20.2	+ 16.5	+ 11.0	+ 9.1
Imports of goods[2]							
Volume		+ 7.6	+ 0.2	– 15.1	+ 10.9	+ 7.0	+ 6.7
Value		+ 9.6	+ 4.7	– 18.4	+ 16.3	+ 10.0	+ 8.3
Current balance	billion €	+ 9.62	+ 13.76	+ 7.98	+ 9.01	+ 11.12	+ 13.22
As a percentage of GDP		+ 3.5	+ 4.9	+ 2.9	+ 3.2	+ 3.7	+ 4.3
Long-term interest rate[3]	in percent	4.3	4.4	3.9	3.2	3.6	3.8
Consumer prices		+ 2.2	+ 3.2	+ 0.5	+ 1.9	+ 2.8	+ 2.4
Unemployment rate							
Eurostat definition[4]	in percent	4.4	3.8	4.8	4.4	4.1	4.0
National definition[5]	in percent	6.2	5.9	7.2	6.9	6.4	6.3
Persons in active dependent employment[6]		+ 2.1	+ 1.7	– 1.5	+ 0.8	+ 1.6	+ 0.9
General government financial balance according to Maastricht definition		– 0.4	– 0.5	– 3.5	– 4.1	– 2.9	– 2.6
As a percentage of GDP		.	.	.	.	– 3.4	– 3.0

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.

Due to the rise in raw material and energy prices, consumer price inflation will accelerate markedly to an annual average rate of 2.8 percent in 2011, of which 0.4 percentage points are accounted for by higher indirect taxes decided in the context of fiscal consolidation. These effects will largely fade out in 2012, whereas wage increases may turn out somewhat higher than in 2011. Overall inflation in 2012 is projected at an average of 2.4 percent.

Private consumption will only follow a moderate upward trend over the forecast period, given the limited income gains. Higher inflation will even make for a decline in real per-capita earnings in 2011, turning around only in 2012. On the labour market, however, the cyclical recovery will be clearly visible, with strong advances in employment and declining unemployment, even if the jobless rate will stay above its pre-crisis level: according to national definitions, 6.3 percent of the dependent labour force will be looking for a job by 2012; in the Eurostat definition, 4.0 percent of the total labour force will be out of work.

Lively economic activity and the measures of fiscal consolidation will improve the general government balance. Yet, the statistical inclusion of federal government subsidies to the Austrian Federal Railways (ÖBB) for infrastructure investment into current expenditure will increase the official government deficit. Anticipating the decision on this change in accounting, the general government deficit is projected at 3.4 percent of GDP in 2011 and at a ratio of 3 percent in 2012.

The highest cyclical risks are currently considered to derive from the increase in commodity and energy prices, from the disaster in Japan and from the persistent vulnerability of the international financial system. The present forecast assumes that oil prices and world market quotations for food items will move to a downward path in the course of this year. Further hikes in prices for raw materials, possibly triggered by a deepening crisis in the Arab world, may weigh heavily on the international business cycle upturn. Likewise, the consequences of the natural disaster and the destruction of the nuclear power plants in Japan cannot be fully assessed as yet. Should the latest increase in interest rates for government bonds in the euro area continue and spread to other countries, the situation of government finances in these countries may become more critical and compel the authorities to take further consolidation measures. This could not only dampen further aggregate demand in the euro area, but also add to the fragility of the financial system and potentially jeopardise the stability of Monetary Union.

Strong global activity, but growing risks

The global economy is growing strongly, supported by robust activity in the emerging Asian economies. Demand in the USA is rising steadily, sustained also by the unabated expansionary policy stance. The recovery in the EU, however, remains subdued overall. The major risks for the global recovery derive from rising energy and commodity prices, the crisis in Japan, the persistent fragility of the international financial system, and the additional dampening effects of fiscal restriction in the industrialised countries.

Global economic activity picked up markedly towards the end of 2010. According to the Netherlands' Centraal Planbureau (CPB), world trade in the fourth quarter expanded by a seasonally-adjusted 2.3 percent in volume from the previous period. It thus resumed noticeably, after a steady deceleration in the course of 2010 and quasi-stagnation in the third quarter. Import demand from emerging Asia rose substantially, remaining the key driver of global economic expansion. Industrialised countries' imports, however, advanced only moderately.

Table 2: World economy

	2007	2008	2009	2010	2011	2012
	Percentage changes from previous year					
Real GDP						
World	+ 5.3	+ 2.8	– 0.6	+ 5.0	+ 4.2	+ 4.4
USA	+ 1.9	± 0.0	– 2.6	+ 2.8	+ 2.9	+ 3.0
Japan	+ 2.4	– 1.2	– 6.3	+ 3.9	+ 1.0	+ 2.0
EU 27	+ 3.0	+ 0.5	– 4.2	+ 1.8	+ 1.7	+ 1.7
Euro area 16	+ 2.9	+ 0.4	– 4.1	+ 1.7	+ 1.5	+ 1.5
Germany	+ 2.7	+ 1.0	– 4.7	+ 3.6	+ 2.7	+ 1.8
New EU countries[1]	+ 6.0	+ 4.1	– 2.9	+ 2.3	+ 2.8	+ 3.8
China	+ 14.2	+ 9.6	+ 9.2	+ 10.3	+ 9.5	+ 9.0
World trade, volume	+ 7.4	+ 2.5	– 13.0	+ 15.1	+ 8.0	+ 8.5
Market growth[2]	+ 7.1	+ 3.3	– 13.0	+ 12.6	+ 8.5	+ 7.8
Primary commodity prices						
HWWI index, total	+ 2.6	+ 21.7	– 30.4	+ 36.4	+ 23	+ 5
Excluding energy	+ 8.1	+ 9.5	– 23.6	+ 38.4	+ 18	+ 9
Crude oil prices						
Brent, $ per barrel	72.5	97.0	61.5	79.5	100	100
Exchange rate						
$ per euro	1.371	1.471	1.393	1.327	1.35	1.30

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.

In China, real GDP increased by slightly over 10 percent in 2010, largely driven by buoyant investment. Tendencies of overheating on real estate and stock markets abated somewhat, whereas consumer price inflation accelerated to an almost 5 percent annual rate most recently. Chinese monetary authorities reacted by stepwise raising interest and minimum reserve rates. This should lead to a gentle slowdown of GDP growth to 9½ percent in 2011 and 9 percent in 2012.

Also in India and the East-Asian emerging markets, economic activity will stay buoyant. A dampening factor in the region could be the rise in food prices which has a large impact on consumer demand. Many Latin American countries, on the other hand, benefit as raw material producers from higher world market prices. Together with lively consumer demand, this bodes well for dynamic economic growth to continue. Yet, the strong inflow of foreign capital drives the exchange rate up, notably in Brazil. This will weigh on export growth and exposes the economy to the instability of international financial markets. In Russia, the rise in oil prices leads to higher investment and private consumption, as well as to a boom in public revenues.

The Japanese economy follows a moderate upward trend. Growth has so far been supported by exports, while domestic demand remains sluggish. After the strong earthquake, the ensuing tsunami and the nuclear reactor accident in Fukushima, short-term disruptions in production are likely, which may hold back economic growth, particularly in the first half of 2011. At present, however, the full extent of output losses cannot yet be reliably assessed. The subsequent compensation of damages and reconstruction will have an expansionary impact. Against this background, real GDP may increase by 1 percent in 2011 and 2 percent in 2012.

Growth in the USA to continue

In the USA, real GDP rose by 0.8 percent in the fourth quarter 2010 from the previous period. Thus, economic activity proved relatively strong for the second quarter in a row. Industrial output is rising steadily, benefiting both from exports and from household demand for durable consumer goods. The real estate sector remains the Achilles heel of the business cycle. While after three years of decline house prices fall no further and private residential and commercial building is tentatively heading up, a genuine recovery is not yet visible. This constitutes not only a drag on the construction industry, but also on banks via continued credit defaults.

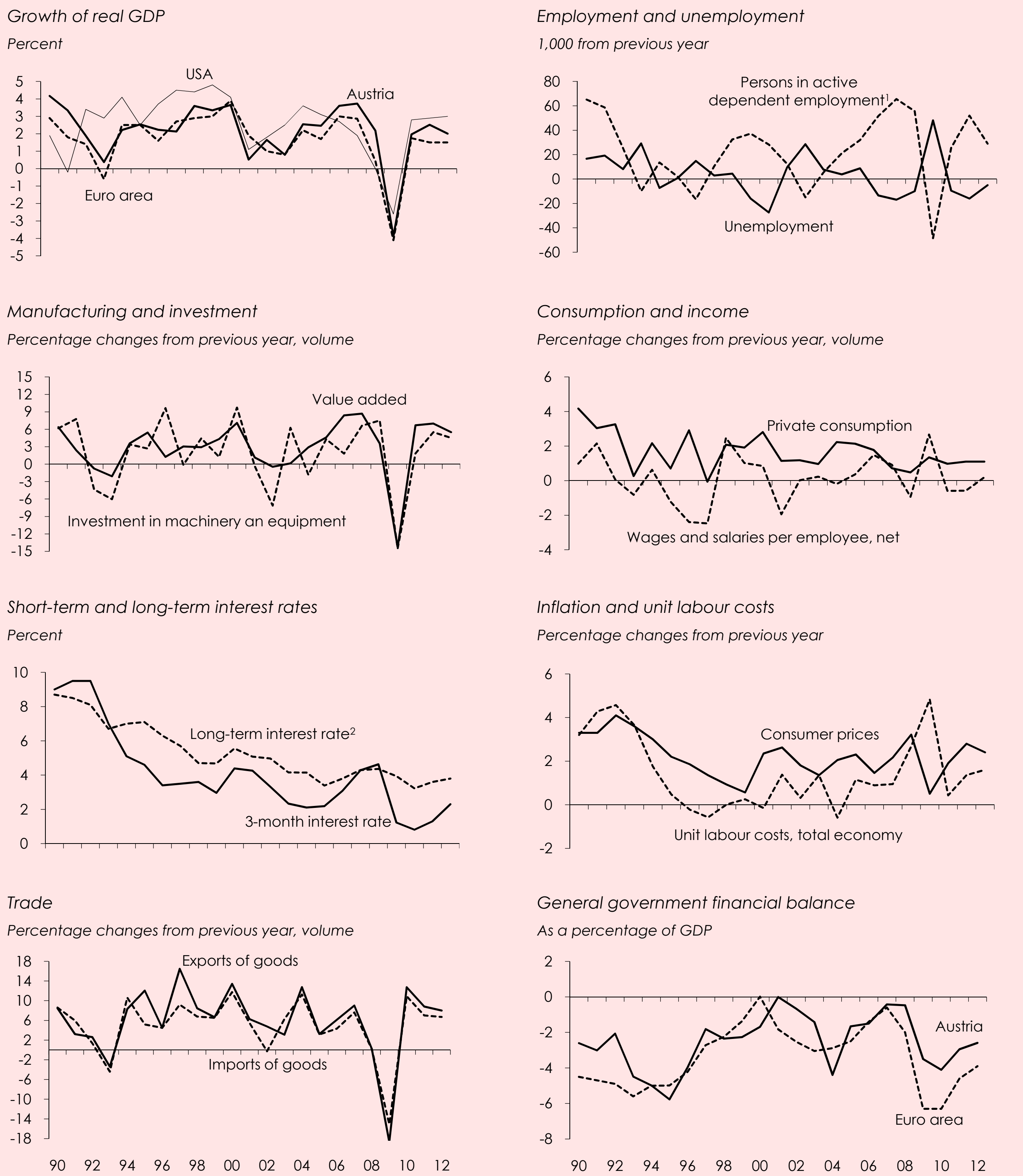
Private consumption is sustained also by a gradual improvement on the labour market: in February, the seasonally adjusted unemployment rate of 8.9 percent of the labour force was down by over 1 percentage point from its peak in October 2009, but still more than 4 percentage points higher than before the recession. Major cyclical support is provided by the continued monetary and fiscal expansion. Interest rates remain low, and fiscal policy does not move towards consolidation for the time being. Real GDP is thus set to expand by 2.9 percent in 2011 and 3.0 percent in 2012, at a similar pace as in 2010.

Subdued cyclical recovery in the EU

The business cycle pattern in the EU is uneven. One group of strongly export-oriented countries, among them Germany, the Netherlands, Austria, the Scandinavian countries, the Czech Republic and Slovakia, which have a large and competitive manufacturing sector, enjoyed dynamic economic growth already in 2010. By contrast, Ireland and several southern European countries could not overcome the recession which in some cases became even more severe. This discrepancy is now widening. As a result, the euro area economy is growing at a modest pace overall.

The dichotomy in the cyclical profile within the euro area is the outcome of largely different demand trends before and after the crisis. In Germany and other export-oriented economies, foreign trade has been the driver of growth since entry into Economic and Monetary Union (EMU). Nominal unit labour cost and consumer prices increased only moderately, and price competitiveness improved markedly vis-à-vis the other euro area countries. At the same time, sluggish gains in disposable income and relatively high real interest rates dampened domestic demand. Conversely, in Ireland and southern Europe, unit labour cost and consumer prices rose swiftly between 1999 and 2007, making for low real interest rates and lively domestic demand. Particularly in Ireland and Spain, the construction sector expanded fast, giving rise to a real estate bubble; at the same time, price competitiveness deteriorated steadily. When the real estate bubbles burst and the financial market crisis broke, high private and public indebtedness held back consumption and investment in Ireland and southern Europe. Because of the limited competitiveness and the long-standing neglect of the export base, these economies participated only to a minor extent in the international cyclical recovery.

Figure 1: Indicators of economic performance



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

In the export-oriented countries, the crisis was mainly felt by a slump in exports. Yet, recovery set in as from the second half of 2009, which proved surprisingly strong such that GDP in some countries bounced back to its pre-crisis level. Internal demand remained broadly stable throughout the recession, but contributed little to the cyclical recovery.

In the euro area, the recovery from the deep recession is making but slow progress. Real GDP is expected to grow by only 1½ percent respectively in 2011 and 2012. The cyclical dichotomy is likely to persist over the forecast period: while the group of export-oriented countries continues to benefit from strong demand from emerging Asia and lively world trade, southern Europe and Ireland still suffer from the direct consequences of the crisis and the impact of fiscal consolidation, making the exit from recession difficult.

In the EU as a whole, real GDP is set to grow by a moderate 1¾ percent respectively in 2011 and 2012. Whereas the Scandinavian and the Eastern European EU economies outside the euro area enjoy above-average growth rates, the pace remains modest in the UK, due to the planned fiscal restriction. Overall, growth incentives for the EU mainly derive from global trade and buoyant demand from the emerging markets in Asia. The recovery thereby is unlikely to be strong enough as to substantially reduce unemployment and fiscal deficits from their high levels attained during the crisis.

International risks on the rise

The risks to the upswing of the world economy are manifold. In the last months, raw material prices have risen significantly. In early March, spot market prices for crude oil have climbed above $ 115 per barrel of Brent, mainly due to the upheavals in the Arab world. Even stronger increases have been recorded for food prices, notably grain, on the back of lively global demand and a string of poor harvests. Likewise, prices of metals are drifting up. In the industrialised countries and the emerging markets, the higher commodity prices have started to feed through to consumer prices, bearing down on consumer demand and GDP growth. Further hikes in commodity prices would reinforce such adverse effects.

The international financial system remains the source of potential risks which in Europe stem from the government debt crisis, and in the USA from the vulnerability of real estate markets. Still more acute are the risks resulting from the incipient change of policy stance in the industrialised countries away from the pronounced expansion followed so far. In particular in a number of EU countries, fiscal policy is moving towards consolidation already in 2011, with significant dampening effects on economic activity.

Cyclical upturn in Austria to continue

The export-driven upswing in Austria has meanwhile spilled over to investment, thereby becoming self-sustained. Nevertheless, growth of private incomes and consumption remains muted. GDP growth is projected at 2.5 percent in 2011 and 2.0 percent in 2012.

Economic activity in Austria expanded strongly in 2010. Real GDP grew by 1.1 percent in the third quarter from the previous period, and by 0.8 percent in the fourth quarter. Exports were the main driving force, but over the last nine months also investment in machinery and equipment posted sizeable gains. Thus, in line with the usual cyclical pattern, the stimulus from exports has been transmitted to investment, enabling the upswing to become self-sustained.

Short-term indicators point to a further strong expansion of demand and output in the first half of the current year. Exports, machinery and equipment investment and manufacturing output are set to make strong headway. As from the middle of the year, however, the pace may slow somewhat, owing to the slackening of global growth, higher oil prices and subdued business activity in the euro area. In the course of 2012, growth should gradually re-accelerate.

Private consumption expenditure and value added of the trade sector follow only a moderate upward trend. Due to the pick-up in inflation, real income gains are extremely narrow. The construction industry is unlikely to pull out of recession during the projection period. Overall, WIFO expects Austria's real GDP to grow by 2.5 percent in 2011 and by 2.0 percent in 2012.

With the cyclical upswing, employment is set to increase. The jobless rate should decline noticeably, though remaining above its pre-crisis level. Also the government budget balance will improve, even if the ruling on the statistical inclusion of federal subsidies to railway infrastructure investment implies an upward shift of the deficit.

The rise in commodity and energy prices is feeding through to consumer prices, leading to a significant increase in headline inflation over the forecast period. The consumer price index is likely to move up by an annual average 2.8 percent in 2011, followed by a somewhat lower 2.4 percent in 2012.

Exports continue to climb swiftly

Thanks to the swift expansion of the world economy, Austrian exports remain on a steep upward trend. Favourable growth prospects for Germany and East-central Europe as well as high price competitiveness further add to the growth momentum.

In 2010, GDP growth was largely export-driven. Real merchandise exports rose by 12.6 percent year-on-year, propelled by demand from Germany and from extra-EU destinations. Austrian firms thereby benefited indirectly from the boom in emerging markets, via supply relations with German manufacturers. In the second half of the year, also deliveries to Switzerland, Russia and the USA increased markedly. The overall strong momentum abated nevertheless in the fourth quarter, with a seasonally-adjusted gain of only 1 percent in volume from the previous quarter. The main reason was modest growth in Germany in the last three months of the year.

Thanks to positive growth perspectives for key export markets, notably in Germany and East-central Europe, exports will stay dynamic over the projection period. Results from the WIFO Business Cycle Survey of last March confirm the benign outlook for exporting firms which are highly satisfied with their orders from abroad. In line with the expected profile of the international cycle, foreign demand is likely to slacken somewhat in the second half of 2011. However, markets in East-central Europe should rebound in 2012 and become more important for Austrian exports than in the current year. High price competitiveness of Austrian suppliers should lead to gains in foreign market shares. Merchandise exports should thus increase by 8.8 percent in volume in 2011, and by 8.0 percent in 2012.

Lively business activity will also stimulate imports, notably driven by buoyant exports and investment in machinery and equipment. In nominal terms, import values will be inflated by higher commodity and energy prices. This effect is likely to be reversed though, as the forecast assumes some easing in oil prices until the end of 2011. At the same time it is assumed that the euro exchange rate vis-à-vis the dollar will decline. Sluggish consumer demand, particularly for durable goods, should dampen import growth. The trade balance surplus is therefore expected to widen over the forecast period.

Strong industrial activity raises investment intentions

The manufacturing sector benefits importantly from buoyant exports. Strong output gains raise the readiness of firms to invest, leading to a marked increase in spending on new machinery and equipment.

The manufacturing sector has so far been the major beneficiary of the cyclical upswing. In 2010, value added increased by 6.7 percent from the previous year when output was most severely hit by the financial market and economic crisis.

Results from the WIFO Business Cycle Survey of last March suggest that rapid output gains will persist, with firms' judgements on their order levels continuously improving. Also expectations for further business developments are highly positive. Manufacturing employment has increased strongly since mid-2010, and production is set to expand at a healthy pace over the forecast period, even if a deceleration of export growth in the second half of 2011 will have a dampening impact. Manufacturing value added is projected to gain 7.0 percent in 2011 and 5.5 percent in 2012.

Table 3: Productivity

	2007	2008	2009	2010	2011	2012
	Percentage changes from previous year					
Total economy						
Real GDP	+ 3.7	+ 2.2	– 3.9	+ 2.0	+ 2.5	+ 2.0
Employment[1]	+ 1.7	+ 2.2	– 0.8	+ 0.8	+ 1.4	+ 0.7
Productivity (GDP per employment)	+ 2.0	– 0.0	– 3.1	+ 1.1	+ 1.1	+ 1.3
Manufacturing						
Production[2]	+ 8.7	+ 3.5	– 14.3	+ 6.7	+ 7.0	+ 5.5
Employees[3]	+ 2.6	+ 1.7	– 5.3	– 1.3	+ 1.2	± 0.0
Productivity per hour	+ 6.3	+ 2.3	– 6.1	+ 5.1	+ 4.7	+ 5.2
Working hours per day per employee[4]	– 0.3	– 0.5	– 3.6	+ 2.8	+ 1.0	+ 0.3

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.

The benign developments in manufacturing leads to a rebound in firms' readiness to invest. Corporate spending on machinery and equipment has been heading up over the last three quarters. For the whole year 2010, it was up by only 1.8 percent from the previous year and still almost 9 percent below its pre-crisis level. The spill-over from export to investment growth points to the cyclical upswing becoming broader-based and self-sustaining. This pattern is consistent with the usual profile of cyclical recovery in Austria. The favourable order situation and high capacity utilisation will encourage firms to invest in additional productive capacity. WIFO expects machinery and equipment investment to expand by 5.5 percent in 2011 and 4.5 percent in 2012.

Construction sector remains in stagnation

Growth of construction is set to remain sluggish over the forecast period. While the outlook for the building sector is on the whole positive, activity in civil engineering is unlikely to pick up.

After a slump of 6.4 percent in 2010, construction output is unlikely to rebound in 2011. On the one hand, the negative carry-over from last year is large, and on the other, output in civil engineering will at best stagnate. Cuts in the federal government investment framework (or the postponement of projects) will have stronger adverse effects already in 2011, but more so as from 2012, than assumed so far. Although some measures adopted in the cyclical stimulus packages will have positive after-effects for civil engineering activity, they are confined to single sub-categories like the railways. Neither will the lower government levels step up demand, least for road construction. This is confirmed by the WIFO Business Cycle Survey and the order situation which both show no signs of improvement.

In the building sector, order inflows are steadily heading up. The forecast for building permits has therefore been revised upwards most recently. A new subsidies programme for energy-saving investments has allocated annual amounts of € 70 million for private homes and € 30 million for commercial buildings up to 2014. For residential building, the shortfall of building promotion subsidies in 2011 should thereby be more than offset. For this reason, the building sector should fare much better over the forecast period than civil engineering. Stable economic growth as from 2012 should have a positive impact on construction activity, underpinned by benign conditions on the labour market, for private incomes, provisions for tax deductibility and financing. For 2012, WIFO expects construction value added to edge up by 1 percent in volume.

Private incomes and consumption advancing at slow pace

Private household expenditure remains on a moderate upward trend. Slow income growth is holding back its momentum.

Private consumption has proved a stabilising force during the financial market and economic crisis. Yet, the cyclical upswing driven by exports and investment has so far not translated into higher household spending which edged up by only 1 percent in volume in 2010. The modest pace is likely to persist, with projected growth rates of just over 1 percent each in 2011 and 2012. In particular demand for durable consumer goods will lag behind, due to an echo-effect of the massive advance purchases of motor cars in 2009 stimulated by the government car-scrapping premium. Expenditure on consumer durables may pick up only as from 2012. Sluggish consumption growth will also weigh on value added of the trade sector which is projected to expand by slightly over 1 percent p.a. over the forecast period.

The lack of dynamism of consumption is explained by the slow pace of real disposable income growth. Although gross earnings per capita should increase by 2.5 percent in 2011 and thus more than in the previous year, real purchasing power will again be eroded by the marked acceleration of inflation. Wage settlements in autumn 2010 were moderate, notably for the public sector, against the background of the low inflation rate at the time. The construction sector settled for an adjustment of wages to price developments which should yield somewhat stronger gains. In the still pending negotiations in spring, rising inflation will also be taken into account. On a separate aspect, wage growth is held back by a growing share of employment being part-time or in low-paid jobs, leading to a negative wage drift; indeed, effective wages are lagging behind contractual wage increases.

In the present forecast it is assumed that the coming autumn wage rounds will settle for higher gains in view of buoyant employment growth and the accompanying fall in unemployment, as well as of rising inflation. In 2012, per-capita wages and salaries are projected to go up by almost 3 percent in nominal terms, enabling slight real wage gains. Private households are expected to accommodate part of the income squeeze over the forecast period by reducing their saving ratio.

Table 4: Private consumption, income and prices

	2007	2008	2009	2010	2011	2012
	Percentage changes from previous year					
Private consumption expenditure	+ 0.7	+ 0.5	+ 1.3	+ 1.0	+ 1.1	+ 1.1
Durables	+ 2.6	+ 1.7	+ 5.2	− 1.0	+ 0.5	+ 1.0
Non-durables and services	+ 0.5	+ 0.3	+ 1.0	+ 1.2	+ 1.2	+ 1.1
Household disposable income	+ 2.3	+ 0.9	− 0.0	+ 0.0	+ 0.9	+ 0.9
	As a percentage of disposable income					
Household saving ratio[1]	11.6	11.8	11.1	10.0	9.9	9.7
Household saving ratio[2]	11.2	11.6	10.4	9.6	9.4	9.2
	Percentage changes from previous year					
Direct lending to domestic non-banks[3]	+ 3.6	+ 7.4	− 1.3	+ 2.9	+ 5.0	+ 4.8
	Percentage changes from previous year					
Inflation rate						
National	2.2	3.2	0.5	1.9	2.8	2.4
Harmonised	2.2	3.2	0.4	1.7	2.9	2.4
Core inflation[4]	1.9	2.4	1.5	1.2	2.2	2.2

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

	2007	2008	2009	2010	2011	2012
	Percentage changes from previous year					
Gross earnings per employee[1]	+ 3.1	+ 2.9	+ 1.5	+ 1.6	+ 2.5	+ 2.9
Gross real earnings per employee[2]	+ 0.9	− 0.3	+ 1.0	− 0.3	− 0.3	+ 0.5
Net real earnings per employee[2]	+ 0.9	− 0.9	+ 2.7	− 0.6	− 0.6	+ 0.2
Total economy						
Unit labour costs	+ 0.9	+ 2.7	+ 4.8	+ 0.4	+ 1.4	+ 1.6
Manufacturing						
Unit labour costs	− 2.3	+ 1.1	+13.5	− 5.4	− 2.7	− 2.3
Effective exchange rate, manufactures						
Nominal	+ 1.2	+ 1.1	+ 0.7	− 2.6	− 0.4	− 0.6
Real	+ 0.8	+ 0.6	+ 0.4	− 2.7	− 0.2	− 0.4

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

Benign business conditions improving labour market outlook

The favourable business situation leads to a marked increase in the number of jobs. Unemployment is thereby brought onto a firm downward trend, although remaining above its pre-crisis level.

The favourable business situation leads to a clear improvement of labour market conditions. In February, the number of persons in dependent active employment was up by 74,000 year-on-year, the number of unemployed down by 21,000. Developments were particularly positive in January and February, when employment increased in all sectors.

With the cyclical upswing continuing, demand for labour is set to rise further, although the slower momentum of activity later this year will dampen the pace of job creation. For 2011 and 2012, WIFO expects employment growth at 1.6 percent and 0.9 percent, respectively. The jobless rate will edge down to 6.4 percent (2011) and 6.3 percent (2012) of the dependent labour force, corresponding to rates of 4.1 percent and 4.0 percent according to Eurostat definitions. The number of unemployed will still be 17,500 higher than at the trough in 2008, or by 30,000 if people enrolled in job training sponsored by the labour administration are included.

Table 6: Labour market

		2007	2008	2009	2010	2011	2012
		Changes from previous year, in 1,000					
Demand for labour							
Persons in active employment[1]		+ 64.7	+ 66.0	– 44.0	+ 31.3	+ 58.0	+ 34.0
Employees[2]		+ 65.5	+ 55.6	– 48.5	+ 25.5	+ 52.0	+ 29.0
Percentage changes from previous year		+ 2.1	+ 1.7	– 1.5	+ 0.8	+ 1.6	+ 0.9
Nationals		+ 43.6	+ 31.1	– 43.0	+ 5.8	+ 21.0	+ 11.0
Foreign workers		+ 21.9	+ 24.5	– 5.5	+ 19.7	+ 31.0	+ 18.0
Self-employed[3]		– 0.8	+ 10.4	+ 4.5	+ 5.8	+ 6.0	+ 5.0
Labour supply							
Population of working age	15 to 64 years	+ 15.5	+ 27.7	+ 17.3	+ 25.7	+ 30.1	+ 16.9
	15 to 59 years	+ 17.1	+ 17.6	+ 11.1	+ 12.0	+ 15.5	+ 16.7
Labour force[4]		+ 47.8	+ 56.0	+ 4.0	+ 21.8	+ 42.0	+ 29.0
Surplus of labour							
Registered unemployed[5]		– 16.9	– 10.0	+ 48.1	– 9.5	– 16.0	– 5.0
In 1,000		222.2	212.3	260.3	250.8	234.8	229.8
Unemployed persons in training[5]	in 1,000	52.7	50.5	64.1	73.2	65.2	63.2
		In percent					
Unemployment rate							
Eurostat definition[6]		4.4	3.8	4.8	4.4	4.1	4.0
As a percentage of total labour force[5]		5.6	5.3	6.5	6.2	5.8	5.6
National definition[5, 7]		6.2	5.9	7.2	6.9	6.4	6.3
Employment rate							
Persons in active employment[1, 8]		64.9	65.7	64.7	65.0	65.7	66.1
Total employment[6, 8]		71.4	72.1	71.6	71.7	72.2	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, without self-employed. – [8] As a percentage of population of working age (15 to 64 years).

At the same time, labour supply is growing markedly. The expected cuts in public spending on active labour market programmes, the population shift towards age groups of high labour force participation (45 to 55 year olds) and the introduction of a guaranteed minimum income will all be reflected in an increase in labour supply. The opening of the Austrian labour market for workers from the new EU countries creates an additional element of uncertainty; it has been included into the present forecast on the basis of the distribution of migration flows over time and of potential substitution and crowding-out effects.

The unexpectedly buoyant order situation in manufacturing was mirrored in 2010 by a substantial increase in hours worked per capita. Meanwhile, lively demand and output growth has been translated into higher employment rather than further rises in work hours. Hourly productivity in manufacturing is thus likely to make further strong advances, with unit labour cost edging down.

Higher commodity and energy prices driving up inflation

The rise in raw material and energy prices as well as higher indirect taxes gives rise to an acceleration of headline inflation. These effects should abate in 2012.

Prices of raw materials and energy have drifted upward swiftly over the last few months. While the price of crude oil (Brent) oscillated between $ 75 and $ 85 from end-2009 to November 2010, it had climbed above $ 115 per barrel by March 2011, as a consequence of the political events in northern Africa and the Middle East. World market prices of agricultural commodities also rose significantly, under the combined impact of sustained growth of worldwide demand and supply constraints caused by several weather-related shortfalls (Russia, Australia, northern China) and political upheavals (Ivory Coast). With the business cycle upswing, prices of metals and other industrial commodities also increased substantially.

The hike of raw material and energy prices is feeding through to consumer prices, driving headline inflation up to 3 percent in February. One-third of the year-on-year increase was due to dearer oil products (fuels and heating oil), around 0.7 percentage points were accounted for by food prices including alcohol and tobacco (+4.3 percent year-on-year in February). Whereas in the last two years, the pace of inflation in Austria was very close to the euro area average, a significant gap has opened since the beginning of 2011, with a differential vis-à-vis the euro area of

0.7 percentage points by February. Even wider was the difference in the rate of core inflation (excluding energy and unprocessed food), which in Austria was 1 percentage point above the euro area average, on account of strong upward pressure on non-energy manufactures and services. Since inflation persistence tends to be much higher in these two categories than in others, this inflation differential is likely to last for the rest of the current year.

In the context of the government's fiscal consolidation programme, several indirect taxes were increased (mineral oil tax and tobacco tax as from 1 January 2011, car registration tax as from 1 March 2011) or newly introduced (air ticket charge as of 1 April 2011); they add about 0.4 percentage points to the annual consumer price index increase in 2011. Yet, the hikes of the mineral oil and tobacco tax explain less than half of the inflation differential vis-à-vis the euro area average.

The present forecast is based on the assumption that oil and food prices will ease in the further course of 2011 and follow thereafter their moderate upward long-term trend. In such a scenario, consumer prices may rise by 2.8 percent on annual average 2011. The indirect tax increases will no longer have a major impact on the inflation rate in 2012. Likewise, the upward pressure from food and energy prices should subside, whereas wage increases may turn out somewhat higher than in 2011. Overall, headline inflation is projected to moderate to 2.4 percent in 2012.

Cyclical upturn and fiscal consolidation lower the budget deficit, but new accounting rule shifts it upwards

Consolidation of public finances will benefit from the favourable cyclical conditions, such that tax receipts will grow faster over the forecast horizon than expected so far. In addition, for 2011 and 2012, the government has adopted consolidation measures to the amount of € 2.6 billion and € 3.79 billion respectively. On the assumption that the measures will actually be implemented and that the Länder and municipalities will not exceed their deficit ceilings of 0.75 percent (2011) and 0.6 percent of GDP (2012) that were agreed in the new national stability pact of March 2011, the general government deficit is currently expected to narrow 2.9 percent of GDP in 2011 and 2.6 percent of GDP in 2012.

Table 7: Key policy indicators

	2007	2008	2009	2010	2011	2012
	As a percentage of GDP					
Fiscal policy						
General government financial balance						
According to Maastricht definition	− 0.4	− 0.5	− 3.5	− 4.1	− 2.9	− 2.6
According to National Accounts	.	.	.	.	− 3.4	− 3.0
General government primary balance	+ 2.3	+ 2.1	− 0.8	− 1.4	− 0.3	+ 0.1
General government primary balance[1]	.	.	.	.	− 0.8	− 0.4
	In percent					
Monetary policy						
3-month interest rate	4.3	4.6	1.2	0.8	1.3	2.3
Long-term interest rate[2]	4.3	4.4	3.9	3.2	3.6	3.8
	Percentage changes from previous year					
Effective exchange rate						
Nominal	+ 1.1	+ 1.2	+ 0.9	− 2.5	− 0.4	− 0.6
Real	+ 0.7	+ 0.6	+ 0.4	− 2.7	− 0.2	− 0.4

Source: WIFO Economic Outlook. – [1] Calculated considering financial contributions to the Austrian Federal Railways (ÖBB) for compensation of infrastructural investments as government spendings. – [2] 10-year central government bonds (benchmark).

Benign cyclical conditions will facilitate fiscal consolidation, the deficit is set to narrow markedly over the forecast period. However, the statistical inclusion of financial subsidies to railway infrastructure investment will weaken the government balance.

Following a Eurostat decision, the federal financial subsidies to infrastructure investment by the Austrian Federal Railways (ÖBB), granted on the basis of an agreement since 2007, will henceforth have to be included to full extent into the Maastricht government balance. Taking into account the new ruling, the deficit trajectory may shift upwards to ratios of 3.4 percent (2011) and 3.0 percent of GDP (2012).

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.

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".