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Economy Set to Stabilise from Mid-2019

Economic Outlook for 2019 and 2020

Economy Set to Stabilise from Mid-2019. Economic Outlook for 2019 and 2020
Under the impact of sluggish global trade, industrial activity in Austria has moved to a downward trend. On major export markets, demand for Austrian manufactures nevertheless proves resilient (USA, CEEC). The temporary setback in German motor car production and its repercussions on Austrian suppliers are gradually subsiding, and the USA-China trade conflict has eased. Moreover, continued solid demand for services helps sustain overall economic activity. Annual average GDP growth in Austria is expected to slow from 2.7 percent in 2018 to 1.7 percent in 2019; from the middle of the year, demand and output are set to stabilise, with growth in 2020 staying around 1.8 percent.

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All staff members of the Austrian Institute of Economic Research contribute to the Economic Outlook. For definitions used see "Methodological Notes and Short Glossary", https://www.wifo.ac.at/wwadocs/form/WIFO-BusinessCycleInformation-Glossary.pdf • Cut-off date: 29 March 2019.

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From a dynamic upturn, Austria's output cycle reached a peak in mid-2018, with industrial production now heading down. Going forward, optimistic and pessimistic expectations by manufacturers broadly balance out, while those of construction firms and service providers are more upbeat. Already in 2018, many firms curbed investment, stockbuilding and imports. During the second half of 2019, the downward trend should ebb, with adverse factors becoming partly offset and policy worldwide taking counter-cyclical action.

Sluggish global trade and weakening industrial production in Germany currently dampen exports and domestic manufacturing output growth. The adverse impact from world trade is limited, however, by the fact that it largely results from the bilateral USA-China conflict. The production shortfall in the German motor car industry that had been triggered by the backlog in certification procedures in autumn 2018, had negative repercussions for domestic suppliers of components; the latter account for about one-seventh of total goods exports to Germany. Other branches have been less affected and part of the losses on the German market will be recuperated. Though slackening during 2019, exports will still provide a positive contribution to GDP growth, notably thanks to robust demand from the USA for capital goods and buoyant activity in Central eastern Europe.

Domestic private consumption increasingly becomes the main pillar of the business cycle. Wage settlements for 2019 slightly above the longer-term average and moderate fiscal stimulus (via the new "family bonus") strengthen household purchasing power, benefitting mainly the demand for services. Thanks to the high labour intensity of the service sector, overall employment remains upward bound over the projection period, despite some job losses in manufacturing. Unemployment is expected to keep falling only in 2019, whereas in 2020 job creation is unlikely to remain strong enough for a further decline. Steady employment growth will boost tax revenues that should outpace government spending (due to low pressure from major items like debt service cost or retirement benefits), allowing the general government balance to move to a small surplus.

Table 1: Main results

		2015	2016	2017	2018	2019	2020
		Percentage changes from previous year					
Gross domestic product, volume		+ 1.1	+ 2.0	+ 2.6	+ 2.7	+ 1.7	+ 1.8
Manufacturing		+ 1.3	+ 3.5	+ 4.8	+ 4.7	+ 1.5	+ 2.0
Wholesale and retail trade		+ 1.9	+ 1.2	+ 1.1	+ 1.1	+ 1.3	+ 1.6
Private consumption expenditure[1], volume		+ 0.4	+ 1.4	+ 1.4	+ 1.6	+ 1.7	+ 1.7
Consumer durables		+ 1.9	+ 3.0	+ 0.5	– 1.4	– 0.5	+ 2.5
Gross fixed capital formation, volume		+ 2.3	+ 4.3	+ 3.9	+ 3.3	+ 2.3	+ 1.8
Machinery and equipment[2]		+ 4.3	+ 7.8	+ 4.2	+ 3.7	+ 2.8	+ 2.4
Construction		+ 0.1	+ 0.4	+ 3.5	+ 2.8	+ 1.8	+ 1.2
Exports, volume		+ 3.5	+ 2.7	+ 4.7	+ 4.4	+ 3.1	+ 3.6
Exports of goods, fob		+ 3.5	+ 2.1	+ 4.9	+ 5.1	+ 3.1	+ 4.0
Imports, volume		+ 3.6	+ 3.4	+ 5.1	+ 2.8	+ 2.5	+ 3.0
Imports of goods, fob		+ 4.1	+ 3.2	+ 4.2	+ 2.7	+ 2.6	+ 3.4
Gross domestic product, value		+ 3.3	+ 3.5	+ 3.8	+ 4.4	+ 3.8	+ 3.7
	billion €	344.26	356.24	369.90	386.09	400.66	415.47
Current account balance	as a percentage of GDP	1.7	2.5	2.0	2.0	1.9	1.8
Consumer prices		+ 0.9	+ 0.9	+ 2.1	+ 2.0	+ 1.7	+ 1.8
Three-month interest rate	percent	– 0.0	– 0.3	– 0.3	– 0.3	– 0.3	0.1
Long-term interest rate[3]	percent	0.7	0.4	0.6	0.7	0.7	1.8
General government financial balance, Maastricht definition	as a percentage of GDP	– 1.0	– 1.6	– 0.8	0.0	0.4	0.7
Persons in active dependent employment[4]		+ 1.0	+ 1.6	+ 2.0	+ 2.5	+ 1.6	+ 1.1
Unemployment rate							
Eurostat definition[5]		5.7	6.0	5.5	4.9	4.6	4.6
National definition[6]		9.1	9.1	8.5	7.7	7.3	7.3

Source: WIFO. 2019 and 2020: forecast. – [1] Including non-profit institutions serving households. – [2] Including weapons systems. – [3] 10-year central government bonds (benchmark). – [4] Excluding persons in valid employment contract receiving child care benefit or being in military service. – [5] As a percentage of total labour force, Labour Force Survey. – [6] As a percentage of dependent labour force, unemployed persons according to Public Employment Service Austria.

1. Détente in the China-USA trade conflict

China's economic growth is decelerating, but still robust

On 24 September 2018, the trade dispute of the USA with China culminated with the introduction of a 10 percent punitive tariff on consumer goods imported from China to an amount of 200 billion $. In certain areas, bilateral trade between the USA and China was thereby seriously impaired, with adverse repercussion for China's suppliers in Southeast Asia. Intermediate inputs imported from Germany were affected to a lesser extent. On 24 February 2019, President Trump announced that in the face of "substantial progress" achieved "on important structural issues including intellectual property protection, technology transfer, agriculture, services, currency and many other issues", tariff rates on Chinese goods would not for the time being be raised to 25 percent, as earlier envisaged. In a subsequent step, a comprehensive agreement between the USA and China shall be elaborated. The tariffs introduced so far may remain in force until further notice.

Austria hardly suffered any negative effects from the USA-China trade dispute. Indeed, deliveries both to the USA and China posted particularly strong gains in 2018, as manufacturers may have profited from the diversion of trade flows. However, a separate risk for the Austrian economy derives from the current cyclical downturn in China as such, even if the latter should not be overrated. Real value indicators, notably for output, often give but a limited impression of actual cyclical developments, since they are not always reliable for political reasons. In some instances, nominal figures give better evidence. Thus, value added of manufacturing industry and construction in the fourth quarter of 2018 increased by 10 percent year-on-year in nominal terms – a robust performance in a longer-term perspective. Moreover, economic policy has taken several expansionary measures: the Central Bank has announced a cut in minimum reserve requirements, and the central government allows communal administrations to carry forward part of the annual debt allocations in order to accelerate the financing of infrastructure projects.

2. Pro-cyclical fiscal policy kindles upturn in the USA

US economic growth accelerated to 2.9 percent in 2018. Major driver was private investment, stimulated by the corporate tax reform that entered into force at the beginning of the year. The reform set a time limit for more generous depreciation rules, which encourages planned projects being carried forward. Private consumption also remains lively. The administration shutdown between 22 December 2018 and 25 January 2019 dampened consumer sentiment only temporarily. The 350,000 to 375,000 public sector employees concerned were compensated retroactively. At a meeting in January, the decision-making body of the US Central Bank signalled its intention to refrain from further interest rate hikes for an unspecified period. The move took markets by surprise and implies a relaxation of monetary conditions in the USA. Likewise, fiscal policy remains expansionary in 2019 and will stimulate economic growth.

Table 2: International economy

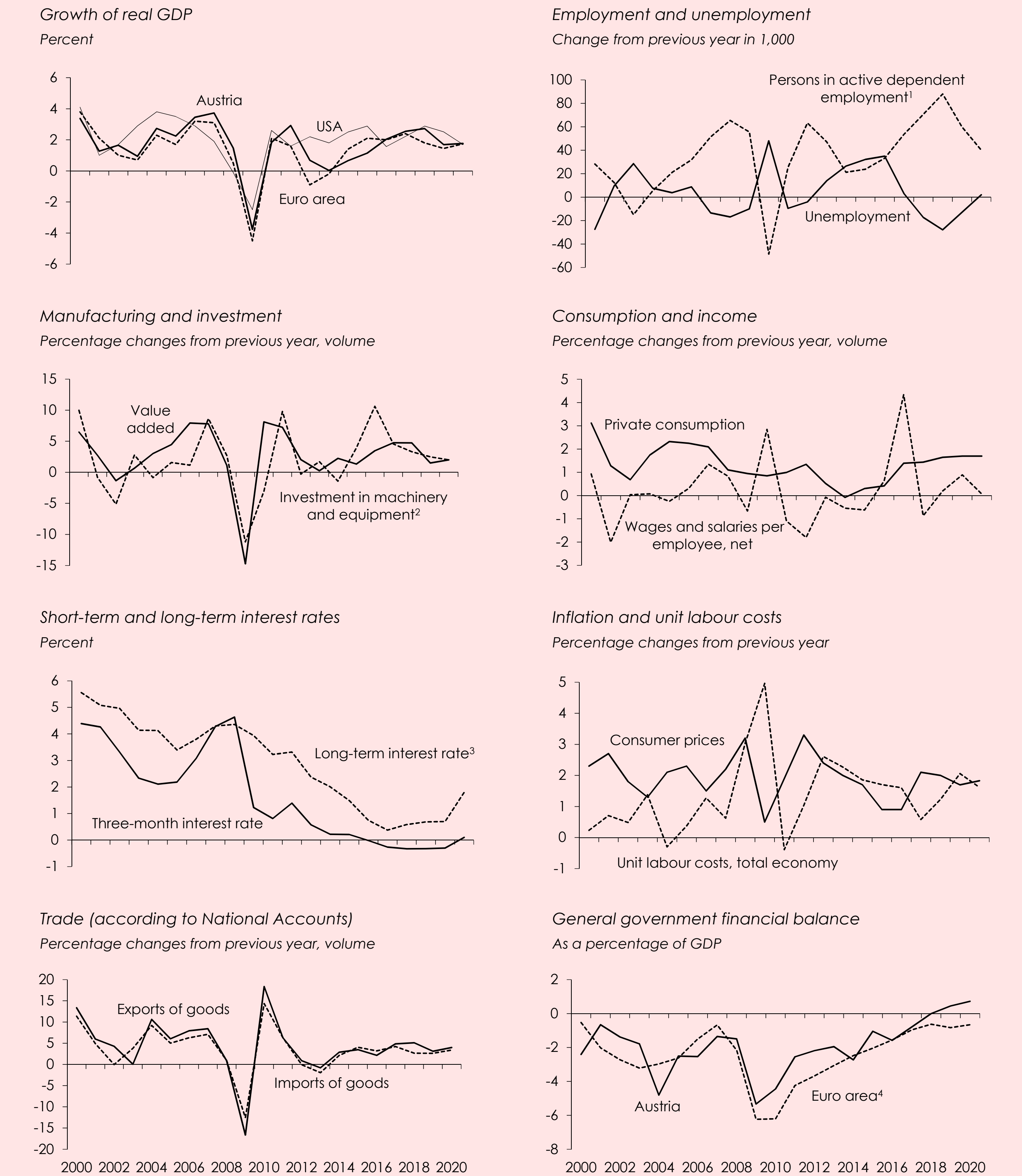
	Percentage shares 2017		2015	2016	2017	2018	2019	2020
	Austria's exports of goods	World GDP[1]	GDP volume, percentage changes from previous year					
EU 28			+ 2.3	+ 2.0	+ 2.4	+ 1.9	+ 1.6	+ 1.8
EU 27	67.0	14.2	+ 2.3	+ 2.1	+ 2.6	+ 2.0	+ 1.7	+ 1.8
Euro area	52.2	11.6	+ 2.1	+ 2.0	+ 2.4	+ 1.8	+ 1.4	+ 1.7
Germany	30.2	3.3	+ 1.7	+ 2.2	+ 2.2	+ 1.4	+ 1.0	+ 1.8
Italy	6.4	1.8	+ 0.9	+ 1.1	+ 1.6	+ 0.9	+ 0.2	+ 1.0
France	4.9	2.2	+ 1.1	+ 1.2	+ 2.2	+ 1.5	+ 1.2	+ 1.4
CEEC 5[2]	14.3	1.6	+ 4.0	+ 2.9	+ 4.5	+ 4.5	+ 3.3	+ 2.6
Czech Republic	3.7	0.3	+ 5.3	+ 2.5	+ 4.4	+ 3.0	+ 2.6	+ 2.2
Hungary	3.4	0.2	+ 3.5	+ 2.3	+ 4.1	+ 4.9	+ 3.4	+ 2.5
Poland	3.1	0.9	+ 3.8	+ 3.1	+ 4.8	+ 5.1	+ 3.5	+ 2.7
USA	6.8	15.3	+ 2.9	+ 1.6	+ 2.2	+ 2.9	+ 2.5	+ 1.7
Switzerland	5.3	0.4	+ 1.3	+ 1.6	+ 1.6	+ 2.5	+ 1.2	+ 1.7
UK	2.8	2.3	+ 2.3	+ 1.8	+ 1.8	+ 1.4	+ 1.2	+ 1.4
China	2.6	18.2	+ 6.9	+ 6.7	+ 6.8	+ 6.6	+ 6.2	+ 5.8
Total[3]								
PPP-weighted[4]		50	+ 4.0	+ 3.4	+ 3.9	+ 3.9	+ 3.5	+ 3.2
Export weighted[5]	84		+ 2.4	+ 2.1	+ 2.6	+ 2.4	+ 2.0	+ 1.9
Market growth[6]			+ 3.7	+ 3.4	+ 6.5	+ 5.0	+ 4.2	+ 4.2
Forecast assumptions								
Crude oil prices								
Brent, $ per barrel			52.5	43.7	54.3	71.0	65	64
Exchange rate								
$ per €			1.110	1.107	1.129	1.181	1.15	1.16
Key interest rate								
ECB main refinancing rate[7], percent			0.1	0.0	0.0	0.0	0.0	0.1
10-year government bonds yields Germany, percent			0.5	0.1	0.3	0.4	0.4	1.6

Source: WIFO. 2019 and 2020: forecast. – [1] PPP-weighted. – [2] Czech Republic, Hungary, Poland, Slovenia, Slovakia. – [3] EU 27, UK, USA, Switzerland, China. – [4] Weighted by GDP at purchasing power parities in 2017. – [5] Weighted by shares of Austrian goods exports in 2017. – [6] Real import growth of trading partners, weighted by shares of Austrian goods exports. – [7] Minimum bid rate.

The cyclical upswing in the USA has by now reached an advanced stage. The unemployment rate is extremely low (3.8 percent in February), core inflation stands at 2 percent, and share prices have resumed moving up from a temporary setback. The small yield differential between long- and short-term government bonds may be taken as harbinger of a cyclical turnaround within one to three years from now. Current data do not yet point to slackening activity; hence, the extended upswing is expected to last for the whole of 2019.

For the time being, the US Central Bank will refrain from further raising key interest rates.

Figure 1: Indicators of economic performance



Source: WIFO. 2019 and 2020: forecast. – [1] Excluding persons in valid employment contract receiving child care benefit or being in military service, and unemployed persons in training; break in 2007-08 due to changes in the employment statistics. – [2] Including weapons systems. – [3] 10-year central government bonds (benchmark). – [4] Source: European Commission.

3. Subdued growth in the euro area keeps inflationary pressure low

In the euro area, the cyclical momentum eased in 2018, with GDP growth abating to 1.8 percent. Confidence indicators reached their peak during the year, from where they are now heading down. The business cycle is still at an earlier stage than in the USA. Unemployment remains rather high in a number of countries (e.g., France, Italy, Spain), while core inflation keeps below the target set by the ECB. The latter terminated the purchases of government bonds at the end of 2018 that it had carried out to sustain business activity. First moves towards higher interest rates, however, will not be taken before 2020. In early March the ECB also announced its intention to grant commercial banks "targeted longer-term refinancing operations" in order to bolster their liquidity. This measure is mainly supposed to help banks in economically weak regions in order to rein in their financial market risk. Italian banks in particular will benefit from this. The Italian economy contracted in the third and fourth quarter of 2018 and is struggling to recover. The recession is remarkable insofar as other larger euro area economies like France or Spain recorded very robust growth over the same period. To some extent, the Italian recession may be ascribed to the deteriorating financial market conditions with a jump in bond market yields, after the government had provoked a quarrel with the European Commission over its draft budget plan.

4. Production shortfall in the German car industry to be partially offset

In 2020, the German economy will benefit from a sizeable positive calendar effect, with four additional working days.

In 2018, growth in Germany suffered from a supply bottleneck in the automobile industry. Car manufacturers belatedly responded to new regulations in force since September concerning the exhaust gas measurement for the certification of conformity for new cars, causing substantial delays in registrations. Thousands of passenger cars had to be stored temporarily and production was cut severely. Planned purchases and shipments to other EU countries were postponed. Not only car production was adversely affected, but also service branches closely linked to the car industry. The compensation of the output shortfall assumed for the fourth quarter of 2018 by WIFO in its forecast of last December did not materialise, and production remained sluggish also in early 2019. There are nevertheless indications that the shortfall will at least partly be made up in the further course of the year. Indeed, the Quarterly National Accounts suggest an improvement, since the excessive stock levels caused by the registration delays have to some extent come down from the third to the fourth quarter of 2018. Also, the German automobile industry is enjoying a rise in new orders since the slump in autumn 2018. For the first quarter of 2019 we assume a still modest output increase (given the weakening of the current business situation according to the ifo-Index), but a compensation effect for the second and third quarter. Besides, Germany will benefit from an exceptionally high positive calendar effect in 2020, with four working days more than in 2019.

5. Austria's economy currently in a cyclical downswing

The present cyclical downswing mainly affects Austria's manufacturing industry, while the forces of growth remain intact for construction and the services branches.

After a lively expansion until mid-2018, demand and output growth in Austria slackened thereafter, notably in the manufacturing sector. GDP growth of 0.4 percent from the earlier period in the fourth quarter of 2018 was still robust and in line with WIFO's December 2018 forecast. At the same time, conditions weakened in the manufacturing sector as output and investment in machinery and equipment virtually stagnated. An exception in the secondary sector was the construction industry where output rose by 0.4 percent quarter-on-quarter. Market services even gained 0.6 percent, driven by stable private consumption and buoyant services exports (i.a. tourism). In view of the slack in world trade, goods exports proved largely resilient, with an increase of 0.5 percent from the previous period.

Business surveys suggest the downward trend in manufacturing to last throughout the first half of 2019.

Judging from business survey results, the downturn in manufacturing should have continued in the first quarter of 2019. The deterioration signalled by the German ifo-Index, which due to the close ties of the Austrian industry with its German partners has a certain validity also for domestic developments, is confirmed by latest results from the regular WIFO-Konjunkturtest (business cycle survey). Yet, the downward trend started from a high level, and optimistic expectations of firms are now roughly on a par with pessimistic ones. In the assessment of the present situation the positive responses dominate, and capacity utilisation is still at a high 86 percent. Nevertheless, in the last few months the trend has been clearly downward bound from the earlier high level, and weakening confidence has spread also to construction companies and service providers. However, firms in these sectors are more upbeat than manufacturers and still express confidence on the short-term outlook. All in all, WIFO expects quarterly growth of GDP to moderate to 0.35 percent in the first quarter of 2019 and 0.3 percent in the second quarter. Thereafter, a number of cyclical stabilisation effects should kick in (see below).

Table 3: Gross value added

At basic prices

	2017	2018	2019	2020	2017	2018	2019	2020
	Billion € (reference year 2010)				Percentage changes from previous year			
Volume (chain-linked series)								
Agriculture, forestry and fishing	4.28	4.20	4.20	4.20	+ 3.1	– 1.8	± 0.0	± 0.0
Manufacturing including mining and quarrying	61.26	64.19	65.16	66.46	+ 4.7	+ 4.8	+ 1.5	+ 2.0
Electricity, gas and water supply, waste management	9.72	10.47	10.79	11.11	+ 7.4	+ 7.8	+ 3.0	+ 3.0
Construction	16.52	16.95	17.23	17.44	+ 3.1	+ 2.6	+ 1.7	+ 1.2
Wholesale and retail trade	36.29	36.70	37.17	37.77	+ 1.1	+ 1.1	+ 1.3	+ 1.6
Transportation	16.02	16.90	17.54	18.11	+ 3.0	+ 5.5	+ 3.8	+ 3.2
Accommodation and food service activities	13.50	14.07	14.35	14.61	+ 1.4	+ 4.2	+ 2.0	+ 1.8
Information and communication	10.15	10.41	10.67	10.94	+ 2.6	+ 2.6	+ 2.5	+ 2.5
Financial and insurance activities	12.39	12.36	12.52	12.74	+ 3.4	– 0.2	+ 1.2	+ 1.8
Real estate activities	26.57	27.24	27.78	28.34	+ 1.3	+ 2.5	+ 2.0	+ 2.0
Other business activities[1]	28.36	29.50	30.17	30.78	+ 3.5	+ 4.0	+ 2.3	+ 2.0
Public administration[2]	49.36	49.96	50.61	51.27	+ 1.3	+ 1.2	+ 1.3	+ 1.3
Other service activities[3]	7.74	7.80	7.84	7.88	– 0.1	+ 0.7	+ 0.6	+ 0.5
Total gross value added[4]	291.77	300.22	305.52	311.06	+ 2.6	+ 2.9	+ 1.8	+ 1.8
Gross domestic product at market prices	326.75	335.67	341.35	347.38	+ 2.6	+ 2.7	+ 1.7	+ 1.8

Source: WIFO. 2019 and 2020: forecast. – [1] Professional, scientific and technical activities; administrative and support service activities (NACE M and N). – [2] Including defence, compulsory social security, education, human health and social work activities (NACE O to Q). – [3] Arts, entertainment and recreation; other service activites; activities of households (NACE R to U). – [4] Before deduction of subsidies and attribution of taxes on products.

Table 4: Expenditure on GDP

Volume (chain-linked series)

	2017	2018	2019	2020	2017	2018	2019	2020
	Billion € (reference year 2010)				Percentage changes from previous year			
Final consumption expenditure	231.14	234.01	237.32	240.59	+ 1.4	+ 1.2	+ 1.4	+ 1.4
Households[1]	166.93	169.68	172.57	175.50	+ 1.4	+ 1.6	+ 1.7	+ 1.7
General government	64.22	64.33	64.75	65.07	+ 1.5	+ 0.2	+ 0.7	+ 0.5
Gross capital formation	82.05	84.54	86.25	87.41	+ 5.6	+ 3.0	+ 2.0	+ 1.3
Gross fixed capital formation	77.14	79.67	81.52	83.02	+ 3.9	+ 3.3	+ 2.3	+ 1.8
Machinery and equipment[2]	27.59	28.51	29.22	29.80	+ 4.6	+ 3.3	+ 2.5	+ 2.0
Construction	33.28	34.19	34.81	35.23	+ 3.5	+ 2.8	+ 1.8	+ 1.2
Other investment[3]	16.44	17.15	17.70	18.21	+ 3.7	+ 4.3	+ 3.2	+ 2.9
Domestic demand	315.37	321.23	325.55	330.00	+ 2.7	+ 1.9	+ 1.3	+ 1.4
Exports	187.86	196.10	202.12	209.33	+ 4.7	+ 4.4	+ 3.1	+ 3.6
Travel	13.86	14.26	14.51	14.72	+ 2.9	+ 2.9	+ 1.8	+ 1.5
Minus Imports	176.44	181.43	185.98	191.47	+ 5.1	+ 2.8	+ 2.5	+ 3.0
Travel	7.27	7.64	7.85	8.01	+ 8.6	+ 5.1	+ 2.8	+ 2.0
Gross domestic product	326.75	335.67	341.35	347.38	+ 2.6	+ 2.7	+ 1.7	+ 1.8
Value	369.90	386.09	400.66	415.47	+ 3.8	+ 4.4	+ 3.8	+ 3.7

Source: WIFO. 2019 and 2020: forecast. – [1] Including non-profit institutions serving households. – [2] Including weapon systems. – [3] Mainly intellectual property products (research and development, computer programmes, copyrights).

Table 5: Productivity

	2015	2016	2017	2018	2019	2020
	Percentage changes from previous year					
Total economy						
Real GDP	+ 1.1	+ 2.0	+ 2.6	+ 2.7	+ 1.7	+ 1.8
Hours worked[1]	– 0.4	+ 2.1	+ 1.6	+ 1.7	+ 1.2	+ 1.2
Productivity[2]	+ 1.6	– 0.0	+ 0.9	+ 1.0	+ 0.5	+ 0.6
Employment[3]	+ 0.7	+ 1.4	+ 1.7	+ 1.6	+ 1.2	+ 0.8
Manufacturing						
Production[4]	+ 1.3	+ 3.5	+ 4.8	+ 4.7	+ 1.5	+ 2.0
Hours worked[5]	– 0.1	+ 0.4	+ 1.5	+ 3.3	+ 0.8	– 0.5
Productivity[2]	+ 1.5	+ 3.1	+ 3.2	+ 1.4	+ 0.7	+ 2.5
Employees[6]	+ 0.5	+ 0.6	+ 1.6	+ 2.7	+ 1.2	– 0.2

Source: WIFO. 2019 and 2020: forecast. – [1] Total hours worked by persons employed, National Accounts definition. – [2] Production per hour worked. – [3] Employees and self-employed, National Accounts definition (jobs). – [4] Gross value added, volume. – [5] Total hours worked by employees. – [6] National Accounts definition (jobs).

5.1 Lasting downturn possible, though less likely

While business surveys convey a reliable picture of the current situation and the likely trend for the next few months, the expectations beyond until 2020 are based on expert judgements and forecasting models. WIFO uses several types, i.a. theory-based DSGE models and data-driven factor models. For 2019, all models point to a slowdown of GDP growth from 2018. Including the calendar effect of some 0.1 percent of GDP (one additional working day vis-à-vis 2018), the model calculations yield annual growth rates ranging from 1.5 percent to 2.1 percent, with a mean of 1.8 percent; for 2020, the results vary from +1.3 percent to +2.2 percent, also with a mean value of +1.8 percent, likewise including a calendar effect of +0.1 percent for one extra working day from 2019.

The persistency of the stagnation of world trade and the possibility of companies reacting by holding back with investment decisions give rise to public expectations of a longer-lasting growth slowdown.

In the current public debate, concerns of a lasting downturn and a further deceleration of growth in 2020 are being voiced. The rather clear evidence for the current situation and the strength of the last upswing are interpreted the way that from now an equally strong and sustained downswing will follow. Some elements indeed argue in favour of such a scenario: the stubborn sluggishness of global trade that is only now working through to the Austrian economy, or the fading of a strong domestic investment cycle that will now prompt companies to adopt a wait-and-see attitude. While such factors should not be disregarded, other considerations speak in favour of a stabilisation of activity:

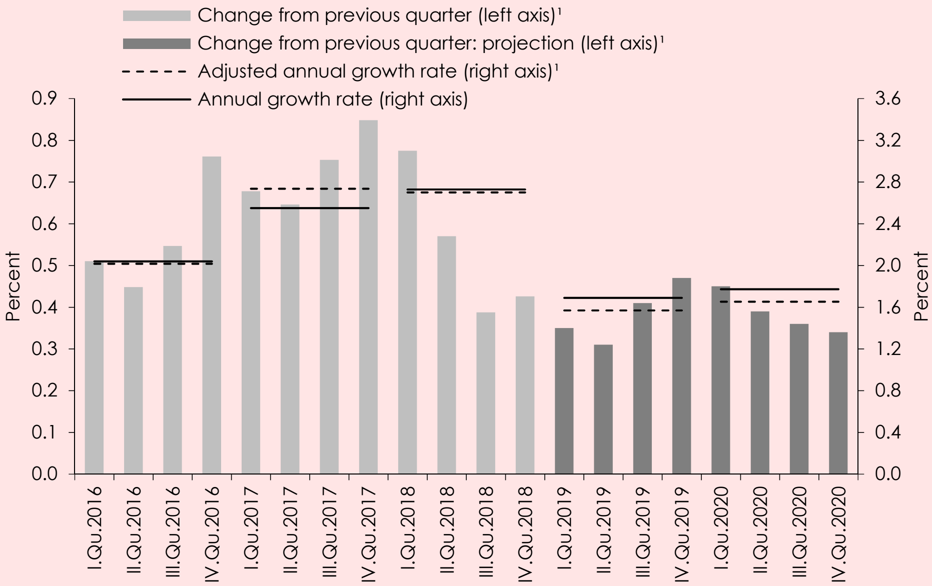
Forecasting model results, policy reaction, one-off and compensation effects all argue for early cyclical stabilisation

First, the forecast models give no clear evidence for a lasting downturn (see above). Second, a cyclical downswing is normally steeper than an upswing and it is already ongoing. Third, economy policy has reacted worldwide to the slackening of growth, though not in a co-ordinated way: the Central Banks in the USA and the euro area have relaxed monetary policy, and the government in China has taken expansionary measures. Fourth, a major element of global trade sluggishness is the USA-China trade conflict that affects Austria only to a minor extent and has meanwhile eased, such that no further restraining effects should be expected. Fifth, the supply-related disruptions in the German motor car sector play to some extent a role in the current downswing in the industrial regions in central Europe; this effect should now be at least partially offset (see above). For these reasons, WIFO assumes that demand and output will stabilise in the second half of 2019.

For the third quarter of 2019, we expect GDP growth at 0.4 percent, slightly accelerating to 0.5 percent in the fourth quarter. During 2020 the momentum is set to gradually abate, yielding for 2019 a year-on-year growth rate of 1.7 percent (slightly below the model results) and for 2020 of 1.8 percent. This profile reflects not only the stabilisation and the compensation effects referred to above, but also the underlying assumption that the consumption-stimulating effects of the "family bonus" will prove strongest in late 2019 and early 2020. Apart from these temporary effects, private consumption will stabilise economic activity more generally throughout the projection period. Construction should also continue to provide positive growth incentives.

Figure 2: Cyclical profile Austria

GDP, volume



Source: WIFO. – [1] Trend-cycle component.

Table 6: Technical breakdown of the real GDP growth forecast

		2017	2018	2019	2020
Growth carry-over[1]	percentage points	+ 1.0	+ 1.2	+ 0.7	+ 0.6
Growth rate during the year[2]	percent	+ 3.0	+ 2.2	+ 1.5	+ 1.5
Annual growth rate	*percent*	*+ 2.6*	*+ 2.7*	*+ 1.7*	*+ 1.8*
Adjusted annual growth rate[3]	percent	+ 2.7	+ 2.7	+ 1.6	+ 1.7
Calendar effect[4]	percentage points	− 0.4	+ 0.0	+ 0.1	+ 0.1

Source: WIFO. 2019 and 2020: forecast. – [1] Impact of year-earlier growth dynamics on growth in the current year. Equals the annual growth rate in the current year, if the level of GDP in the current year remains constant from the fourth quarter of the previous year; trend-cycle component. – [2] Reflects the growth dynamics during a calendar year. Equals the year-on-year growth rate for the fourth quarter; trend-cycle component. – [3] Trend-cycle component. Corresponding figure to OeNB short-term forecast. – [4] Impact of the annual number of working days and the leap day.

5.2 Capacity constraints drive construction prices strongly up

Construction output rose strongly in 2017 and 2018. Business surveys signal continued confidence for the months to come, with lively demand particularly for new building construction. However, many firms are facing capacity limits; unlike industrial manufacturing companies, they cannot to the same extent accommodate excess demand by productivity gains. Hence, inflation of construction prices accelerated to 3.5 percent in 2018. The projected slowdown of real output growth and new investment should thus be seen in the light of capacity constraints. Prices are expected to keep rising swiftly.

5.3 Solid wage growth sustains private consumption

Consumption of durable consumer goods in 2019 will again be moderated by weak demand for new motor cars.

Wages and salaries should post similar solid gains in 2019 as last year. Wage settlements were slightly above the longer-term average, yielding substantial gains in purchasing power per head and per work hour net of tax and inflation. With the cyclical downswing, wage agreements for 2020 will provide for leaner increases. While the family bonus will boost household net incomes in 2019 and 2020, fiscal drag will dampen them – the more so the longer the inflation adjustment of the tax scale is delayed. Further to the family bonus, expansionary private demand effects may derive from planned income tax cuts, which are yet unspecified and not included in the present forecast. Thanks to the overall benign trend in household disposable income, private consumption will help sustain business activity. Yet, purchases of new motor cars keep receding for longer than anticipated. Reasons are on the one hand price increases, since new tests yield higher exhaust gas emissions and lead to higher emission-based car registration taxes; on the other hand, the backlog of car deliveries due to delays in German certification procedures has not yet been completely dissolved. Hence, consumption of durable consumer goods will keep falling year-on-year in 2019. Nevertheless, a turnaround should set in during the year and lead to an annual increase in 2020.

Table 7: Private consumption, income and prices

	2015	2016	2017	2018	2019	2020
	Percentage changes from previous year, volume					
Private consumption expenditure[1]	+ 0.4	+ 1.4	+ 1.4	+ 1.6	+ 1.7	+ 1.7
Durable goods	+ 1.9	+ 3.0	+ 0.5	− 1.4	− 0.5	+ 2.5
Non-durable goods and services	+ 0.3	+ 1.2	+ 1.5	+ 2.0	+ 1.9	+ 1.6
Household disposable income	− 0.2	+ 2.5	+ 0.5	+ 2.1	+ 1.9	+ 1.8
	As a percentage of disposable income					
Household saving ratio						
Including adjustment for the change in pension entitlements	6.8	7.8	6.8	7.2	7.4	7.5
Excluding adjustment for the change in pension entitlements	6.1	7.1	6.2	6.6	6.8	6.9
	Percentage changes from previous year					
Loans to domestic non-banks (end of period)	+ 1.8	+ 1.8	+ 0.9	+ 4.4	+ 1.5	+ 1.8
	Percent					
Inflation rate						
National	0.9	0.9	2.1	2.0	1.7	1.8
Harmonised	0.8	1.0	2.2	2.1	1.6	1.7
Core inflation[2]	1.7	1.5	2.2	1.9	1.7	1.8

Source: WIFO. 2019 and 2020: forecast. – [1] Private households including non-profit institutions serving households. – [2] Excluding energy and unprocessed food (meat, fish, fruits, vegetables).

Table 8: Earnings, international competitiveness

	2015	2016	2017	2018	2019	2020
	Percentage changes from previous year					
Wages and salaries per employee[1]						
Nominal, gross	+ 2.0	+ 2.3	+ 1.4	+ 2.5	+ 2.5	+ 2.1
Real[2]						
Gross	+ 1.1	+ 1.4	− 0.7	+ 0.5	+ 0.8	+ 0.3
Net	+ 0.6	+ 4.3	− 0.9	+ 0.2	+ 0.9	+ 0.1
Wages and salaries per hour worked[1]						
Real, net[2]	+ 2.0	+ 3.6	− 0.8	− 0.0	+ 1.1	+ 0.2
	Percent					
Wage share, adjusted[3]	69.3	68.4	67.9	67.5	67.3	66.8
	Percentage changes from previous year					
Unit labour costs, nominal[4]						
Total economy	+ 1.7	+ 1.6	+ 0.6	+ 1.2	+ 2.1	+ 1.6
Manufacturing	+ 0.9	− 0.5	− 1.2	+ 1.3	+ 2.8	+ 0.6
Effective exchange rate – manufactured goods[5]						
Nominal	− 2.9	+ 1.2	+ 0.7	+ 1.7	+ 0.2	+ 0.4
Real	− 3.1	+ 1.3	+ 1.0	+ 1.7	− 0.1	− 0.0

Source: WIFO. 2019 and 2020: forecast. – [1] National Accounts definition. – [2] Deflated by CPI. – [3] Compensation of employees as a percentage of national income, adjusted for the change in the share of employees in total employment from base year 1995. – [4] Labour costs in relation to productivity (hourly compensation per employees divided by GDP per employed persons' hours worked). – [5] Weighted by exports and imports, real value adjusted by relative HCPI.

Solid wage gains have pushed up industrial unit labour cost by 1.3 percent in 2018 and exerted upward pressure on prices. In 2019, the rise in unit labour cost will gather pace to nearly 3 percent, a usual feature in the wake of cyclical highs as witnessed in 2008 and 2012-13. The overall wage ratio has nevertheless edged down slightly. Thus, the share of value added received by workers and employees for the economy as a whole does not increase, although wages put upward pressure on manufactures prices. The reason is the productivity gap between industry and services: the buoyant demand for services leads to price increases (like in the construction sector), given the limited scope for productivity gains. Inflation in the overall economy is almost entirely driven by the service sector and compensated in the wage rounds. This compensation exerts pressure on the prices of goods that is partially compensated by productivity advances in 2018, but no longer in 2019.

Rising nominal unit labour costs in manufacturing industry fail to boost the overall wage ratio.

5.4 No further decline in unemployment in 2020

Employment growth and the decline in unemployment have hardly lost momentum so far. However, as both indicators are lagging the output cycle, the benign trend may to some extent be the echo of the now-ending boom. Since the latter has boosted cash flow, companies still add to their workforce, unlike in the early stages of an upswing when new hiring is complicated by liquidity constraints. An early indicator of labour market conditions is the behaviour of job vacancies. Their increase has been flattening since autumn 2018, which confirms the diagnosis of cyclical activity now heading down.

Job vacancies have been rising more slowly since autumn 2018, confirming the cyclical downswing in Austria.

Going forward, employment gains are set to narrow, with manufacturing industry possibly cutting personnel. Overall employment is expected to rise by a further 1 percent in 2020, which however will not suffice to keep unemployment on a downward trend. Labour supply is expanding swiftly, due to strong inflow from abroad and rising domestic labour force participation. Competition among jobseekers will intensify from mid-2020, when the access of workers from Croatia will be derestricted. The number of unemployed will not fall below 300,000 on a sustained basis.

Table 9: Labour market

	2015	2016	2017	2018	2019	2020
	Change from previous year in 1,000					
Demand for labour						
Persons in active employment[1]	+ 42.5	+ 62.3	+ 76.8	+ 91.6	+ 63.0	+ 43.0
Employees[1,2]	+ 33.2	+ 53.7	+ 70.7	+ 88.0	+ 60.0	+ 40.0
National employees	+ 6.3	+ 17.7	+ 23.8	+ 33.7	+ 19.0	+ 12.0
Foreign employees	+ 27.0	+ 36.0	+ 46.8	+ 54.4	+ 41.0	+ 28.0
Self-employed[3]	+ 9.3	+ 8.6	+ 6.1	+ 3.6	+ 3.0	+ 3.0
Labour supply						
Population of working age						
15 to 64 years	+ 52.3	+ 65.8	+ 23.0	+ 16.2	+ 9.4	+ 5.8
Labour force[4]	+ 77.5	+ 65.3	+ 59.4	+ 63.8	+ 50.0	+ 45.0
Labour surplus						
Unemployed[5]	+ 35.0	+ 3.0	− 17.3	− 27.9	− 13.0	+ 2.0
Unemployed persons in training	− 10.2	+ 2.1	+ 4.9	− 3.4	− 9.0	− 2.0
	Percent					
Unemployment rate						
As a percentage of total labour force (Eurostat)[6]	5.7	6.0	5.5	4.9	4.6	4.6
As a percentage of total labour force[5]	8.1	8.1	7.6	6.9	6.5	6.5
As a percentage of dependent labour force[5]	9.1	9.1	8.5	7.7	7.3	7.3
	Percentage changes from previous year					
Labour force[4]	+ 1.8	+ 1.5	+ 1.4	+ 1.4	+ 1.1	+ 1.0
Persons in active dependent employment[1,2]	+ 1.0	+ 1.6	+ 2.0	+ 2.5	+ 1.6	+ 1.1
Unemployed[5]	+ 11.0	+ 0.8	− 4.9	− 8.2	− 4.2	+ 0.7
Persons (in 1,000)	354.3	357.3	340.0	312.1	299.1	301.1

Source: WIFO. 2019 and 2020: forecast. – [1] Excluding persons in valid employment contract receiving child care benefit or being in military service. – [2] According to the Organisation of Austrian Social Security. – [3] According to WIFO, including liberal professions and unpaid family workers. – [4] Persons in active employment plus unemployed. – [5] According to Public Employment Service Austria. – [6] Labour Force Survey.

5.5 General government account reaching surplus from 2019

Tax revenues are rising strongly, thanks to lively job creation and private consumption.

Tax revenues grew strongly during the cyclical boom, notably receipts from corporate and capital gains tax, but also from income taxes. The general government account should already have reached balance in 2018. Revenues from labour taxes (wage tax and assessed income tax, social contributions), which account for a large proportion of government revenue, will further increase with rising employment. In addition, stable private consumer demand keeps value added tax revenues on a strong upward path. The present slackening of manufacturing activity should have a limited impact on tax revenue dynamics. The introduction of the Family Bonus causes revenue shortfalls of 0.6 billion € in 2019 and 1.24 billion € in 2020 (in 2019, the tax benefit may be claimed only via companies' payroll accounting for their employees, as from 2020 also via individual tax assessments). Moreover, the projection includes i.a. the cut in the contribution rate for work accident insurance (100 million €) and in the VAT rate on hotel overnight stays from 13 percent to 10 percent (120 million €).

The sustained decline in debt financing cost provides budgetary relief over the entire forecast period.

The rise in public expenditure is dampened mainly by the fall in interest cost that started in 2013 and will hold over the entire forecast period. The largest expenditure item, retirement benefits, will increase further due to population ageing, moderated however by the extension of statutory benefit assessment periods and the rise in the effective retirement age. The wage settlement for the public sector for 2019 will make for a somewhat faster increase in personnel outlays. The abolition of the recovery of nursing care cost from patients' relatives ("Pflegeregress") puts upward pressure on spending on social benefits in kind. Overall public expenditure and revenue will both expand at rates below growth of nominal GDP, implying declines in the expenditure and revenue ratios. With projected expenditure rising less than revenue, the general government surplus is set to widen from 2019 onwards. The projection does not include potential additional costs or savings from the organisational merger of social security agencies, nor any revenue shortfalls from the planned tax cuts. The likely increase in Austria's contribution to the EU budget on account of "Brexit" will not yet become effective over the projection horizon.

Table 10: Fiscal and monetary policy – key figures

	2015	2016	2017	2018	2019	2020
	As a percentage of GDP					
Fiscal policy						
General government financial balance[1]	– 1.0	– 1.6	– 0.8	0.0	0.4	0.7
General government primary balance	1.3	0.5	1.0	1.6	1.8	2.0
General government total revenue	50.1	48.7	48.4	48.5	48.2	47.8
General government total expenditure	51.1	50.3	49.2	48.5	47.7	47.1
	Percent					
Monetary policy						
Three-month interest rate	– 0.0	– 0.3	– 0.3	– 0.3	– 0.3	0.1
Long-term interest rate[2]	0.7	0.4	0.6	0.7	0.7	1.8

Source: WIFO. 2019 and 2020: forecast. – [1] According to Maastricht definition. – [2] 10-year central government bonds (benchmark).

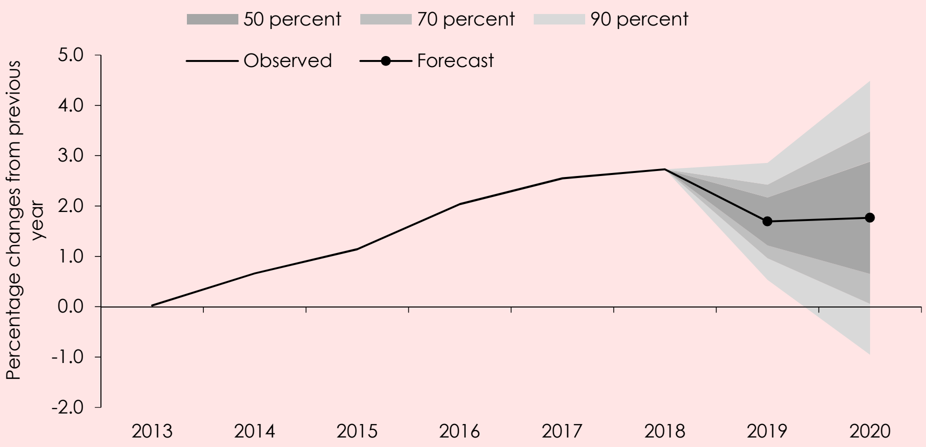
6. Risks to the forecast

After the provisional settlement of the USA-China trade dispute, a rekindling of the conflict between the EU and the USA may pose a serious risk for the Austrian economy, for which the USA is the second-most-important destination of merchandise exports and mainly for goods that may be the target of trade restrictions (machinery, investment goods, motor cars). Moreover, Austria runs a trade surplus with the USA.

The imminent "Brexit" remains a factor of uncertainty, even if, according to all model simulations, the Austrian economy should be but mildly affected. However, such model simulations cannot capture such an unprecedented event in all its ramifications. Moreover, an unorderly withdrawal of the UK from the EU may trigger unforeseeable reactions on international financial markets, with implicit negative repercussions on demand and output in the real economy.

More severely would Austria's economy be affected in case of a crisis in Italy, possibly provoked by a bank run. Italian investors already transfer more of their savings abroad in order to protect them from government access. While the Italian authorities have given in to the EU in the conflict over the draft budget and a further escalation is at present not in sight, the economy has been in recession for the last six months and policy may again resort to erratic action.

Figure 3: Margins of uncertainty for real GDP



Source: WIFO. Calculated on the basis of ex-post revealed forecast errors.

One forecast risk on the domestic front derives from private investment behaviour. While the forecast assumes a mild deceleration, the investment cycle is known to be highly volatile; hence, the strong increase in corporate spending on machinery and equipment since 2016 may soon end in a sharper decline. Besides, the present clouding of confidence, not only in Austria, but in many economies, may take on a self-reinforcing dynamics that would accelerate the cyclical downswing worldwide and impair domestic growth more markedly than implied by the present forecast scenario.