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 **ÖSTERREICHISCHES INSTITUT FÜR
WIRTSCHAFTSFORSCHUNG**

**Solid Domestic Demand Set to
Last Awhile
Economic Outlook for 2017 and 2018**

December 2016



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Austrian Institute of Economic Research

Abstract

Domestic demand is rising swiftly, fuelled by the income tax cuts, which should drive purchases of durable consumer goods well until the middle of 2017. Investment in 2016 was largely concentrated on motor cars, benefitting domestic production to a lesser extent. As the effects of the tax reform taper off and inflation picks up, growth is set to lose some momentum, with high unemployment weighing on consumption and foreign demand rising only moderately. In spite of robust employment growth, job creation cannot keep pace with the access of new labour, keeping the jobless rate on the rise.

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Solid Domestic Demand Set to Last Awhile

Economic Outlook for 2017 and 2018

Domestic demand is rising swiftly, fuelled by the income tax cuts, which should drive purchases of durable consumer goods well until the middle of 2017. Investment in 2016 was largely concentrated on motor cars, benefitting domestic production to a lesser extent. As the effects of the tax reform taper off and inflation picks up, growth is set to lose some momentum, with high unemployment weighing on consumption and foreign demand rising only moderately. In spite of robust employment growth, job creation cannot keep pace with the access of new labour, keeping the jobless rate on the rise.

Aggregate demand is currently growing strongly in Austria. Private households translate their income gains from the tax cuts into higher consumption, and companies in many sectors see their situation improving. Yet, only part of the rising demand benefits domestic production, as purchases of motor cars dominated in 2016, which were either imported or available on stock. Moreover, foreign demand from the USA and CEEC 5 (Poland, Slovakia, Slovenia, Czech Republic, Hungary) is slackening; exports are at present mainly sustained by deliveries to the euro area. The overall external environment should brighten somewhat once investment rebounds in the USA and subsidies from the EU Multiannual Financial Framework resume, which strongly impact on the investment cycle of some East-Central European countries.

Exports of tourism services are performing relatively better than those of goods; being less productivity-enhancing, they have a stronger employment effect, but at the same time exert upward pressure on inflation. Austria's inflation rate therefore remains above the euro-area average, though falling below 1 percent in 2016 for the second year in a row. Assuming an increase in the reference price of oil to 57 \$ per barrel, headline inflation will climb to 1.7 percent in 2017, implying a stagnation of gross real wages per head. Net wages, which were boosted by the tax cuts in 2016, will be squeezed as soon as fiscal drag resumes. Employment growth strengthened in 2016 from the previous year. At the same time the inflow of workers from the new EU member countries, which had increased substantially with the opening of the labour

market, abated, so that the rise in unemployment virtually levelled off. However, in the next few years it will return to an upward trend when the immigrants granted asylum or subsidiary protection status join the labour market.

By mid-2017, once the effect of the tax cuts wears off, consumer demand will lose momentum. The imminent alignment of company car taxation towards environmental objectives has probably triggered pre-emptive purchases to a substantial degree in 2016, suggesting a tapering of the buying spree for 2017. Investment in machinery and equipment may pick up only little, given the moderate outlook for foreign demand. Construction activity is set to rebound, although rising demand for housing space faces income constraints of many customers and high real estate prices. Against this background, aggregate demand growth, pushing the cyclical growth rate from 1.3 percent in 2016 to 1.7 percent in 2017, may subside to 1.4 percent in 2018. Furthermore, GDP growth in 2017 will be dampened by a calendar effect, i.e., the smaller number of working days, yielding projected annual rates of 1.5 percent each for 2016 and 2017, and of 1.4 percent for 2018.

Cut-off date: 14 December 2016

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Methodological Notes and Short Glossary

Ongoing reports on business cycle developments are among the key products provided by WIFO. In order to facilitate their understanding, in-depth explanations on definitions and technical terms are, whenever possible, combined in this glossary rather than supplied in the analytical part.

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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). Unlike the "seasonally and calendar-adjusted" changes of quarterly GDP as communicated to Eurostat and released by Statistics Austria, WIFO in addition adjusts the series for irregular variations. The WIFO series labelled "trend-cycle component" exhibits a smoother path and offers a better interpretation of the cyclical profile.

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_n) 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).

Average rates of change

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

Real and nominal values

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

Production Sector

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

Inflation, CPI und HICP

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

Core inflation as a monetary policy indicator is not clearly defined. WIFO follows the common practice of using the inflation rate excluding the product categories unprocessed food and energy for core inflation. Thus over 87 percent of the goods and services contained in the consumer price index (CPI 2015) 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 1,500 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.konjunkturtest.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 with a valid employment contract. By deducting their number one arrives at the number of "persons in dependent active employment".

Main results

	2013	2014	2015	2016	2017	2018	
	Forecast						
	Percentage changes from previous year						
Gross domestic product , volume	+ 0.1	+ 0.6	+ 1.0	+ 1.5	+ 1.5	+ 1.4	
Manufacturing	+ 0.3	+ 1.6	+ 1.8	+ 2.0	+ 2.3	+ 2.3	
Wholesale and retail trade	- 2.1	+ 2.0	+ 0.6	+ 2.5	+ 2.3	+ 2.0	
Private consumption expenditure ¹ , volume	- 0.1	- 0.3	- 0.0	+ 1.5	+ 1.2	+ 1.1	
Consumer durables	- 3.0	+ 0.1	- 0.6	+ 3.2	+ 2.0	+ 1.0	
Gross fixed capital formation , volume	+ 2.2	- 0.9	+ 0.7	+ 3.7	+ 2.6	+ 2.0	
Machinery and equipment ²	+ 2.4	- 1.0	+ 3.6	+ 7.0	+ 3.5	+ 2.5	
Construction	- 0.9	- 0.1	- 1.2	+ 1.6	+ 1.5	+ 1.3	
Exports , volume	+ 0.5	+ 2.3	+ 3.6	+ 2.8	+ 3.0	+ 3.1	
Exports of goods	- 0.7	+ 2.2	+ 3.5	+ 2.8	+ 3.0	+ 3.5	
Imports , volume	+ 0.7	+ 1.3	+ 3.4	+ 3.7	+ 2.8	+ 2.9	
Imports of goods	- 2.0	+ 0.8	+ 4.2	+ 4.5	+ 3.0	+ 3.2	
Gross domestic product , value	+ 1.7	+ 2.4	+ 2.9	+ 3.0	+ 2.9	+ 3.0	
	billion €	322.54	330.42	339.90	350.22	360.30	371.06
Current account balance as a percentage of GDP	2.0	2.4	1.8	2.4	2.3	2.3	
Consumer prices	+ 2.0	+ 1.7	+ 0.9	+ 0.9	+ 1.7	+ 1.7	
Three-month interest rate percent	0.2	0.2	- 0.0	- 0.3	- 0.3	0.1	
Long-term interest rate ³ percent	2.0	1.5	0.7	0.4	0.6	1.0	
General government financial balance according to Maastricht definition, as a percentage of GDP	- 1.4	- 2.7	- 1.0	- 1.6	- 1.5	- 1.1	
Persons in active dependent employment ⁴	+ 0.6	+ 0.7	+ 1.0	+ 1.5	+ 1.2	+ 1.0	
Unemployment rate							
Eurostat definition ⁵	5.4	5.6	5.7	6.1	6.2	6.2	
National definition ⁶	7.6	8.4	9.1	9.1	9.3	9.5	

¹ Including non-profit institutions serving households. – ² Including weapons systems. – ³ 10-year central government bonds (benchmark). – ⁴ Excluding parental leave and 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.

International economy

		2013	2014	2015	2016	2017	2018
					Forecast		
	Weight ¹ 2015	Real GDP, percentage changes from previous year					
EU	69.1 (16.9)	+ 0.2	+ 1.6	+ 2.2	+ 1.8	+ 1.6	+ 1.7
United Kingdom	3.2 (2.4)	+ 1.9	+ 3.1	+ 2.2	+ 2.0	+ 1.4	+ 2.2
Euro area	51.1 (12.0)	- 0.3	+ 1.2	+ 2.0	+ 1.6	+ 1.5	+ 1.5
Germany	30.0 (3.4)	+ 0.5	+ 1.6	+ 1.7	+ 1.7	+ 1.5	+ 1.6
Italy	6.3 (1.9)	- 1.7	+ 0.1	+ 0.7	+ 0.8	+ 0.8	+ 1.0
France	4.5 (2.3)	+ 0.6	+ 0.6	+ 1.3	+ 1.3	+ 1.4	+ 1.5
CEEC 5²	14.1 (1.6)	+ 1.3	+ 3.2	+ 3.7	+ 2.4	+ 3.0	+ 3.0
Czech Republic	3.6 (0.3)	- 0.5	+ 2.7	+ 4.5	+ 2.4	+ 2.4	+ 2.6
Hungary	3.3 (0.2)	+ 2.1	+ 4.0	+ 3.1	+ 1.5	+ 2.6	+ 2.5
Poland	3.2 (0.9)	+ 1.4	+ 3.3	+ 3.9	+ 2.5	+ 3.5	+ 3.3
USA	6.9 (15.8)	+ 1.7	+ 2.4	+ 2.6	+ 1.5	+ 2.2	+ 2.1
Switzerland	5.8 (0.4)	+ 1.8	+ 2.0	+ 0.8	+ 1.6	+ 1.8	+ 1.9
China	2.5 (17.3)	+ 7.8	+ 7.3	+ 6.9	+ 6.7	+ 6.4	+ 6.1
Total, PPP-weighted³	(50.4)	+ 3.3	+ 3.8	+ 3.9	+ 3.4	+ 3.4	+ 3.3
Total, export-weighted⁴	84.3	+ 0.7	+ 1.9	+ 2.3	+ 1.9	+ 1.8	+ 1.9
Market growth⁵		+ 1.7	+ 3.5	+ 2.9	+ 2.8	+ 3.0	+ 3.5
Forecast assumptions							
		2013	2014	2015	2016	2017	2018
					Forecast		
Crude oil prices							
Brent, USD per barrel		108.7	99.0	52.5	45	57	59
Exchange rate							
USD per euro		1.328	1.329	1.110	1.11	1.10	1.10
Key interest rate							
ECB main refinancing rate ⁶ , percent		0.6	0.2	0.1	0.0	0.0	0.3
10-year government bonds yield Germany, percent		1.6	1.2	0.5	0.1	0.2	0.8

¹ Percentage share of Austrian goods exports. In parenthesis share of global GDP valued at purchasing power parities. –² Poland, Slovakia, Slovenia, Czech Republic, Hungary. –³ EU, USA, Switzerland, China; weighted by GDP valued at purchasing power parities in 2015. –⁴ EU, USA, Switzerland, China; weighted by shares of Austrian goods exports in 2015. –⁵ Real import growth of trading partners, weighted by Austrian goods exports shares. –⁶ Minimum bid rate.

Tabel 1: **Fiscal and monetary policy - key figures**

	2013	2014	2015	2016	2017	2018
					Forecast	
Fiscal policy						
				As a percentage of GDP		
General government financial balance ¹	- 1.4	- 2.7	- 1.0	- 1.6	- 1.5	- 1.1
General government primary balance	1.2	- 0.3	1.3	0.6	0.4	0.6
General government total revenue	49.9	50.0	50.6	49.6	49.5	49.5
General government total expenditure	51.2	52.8	51.6	51.2	50.9	50.6
Monetary policy						
				Percent		
Three-month interest rate	0.2	0.2	- 0.0	- 0.3	- 0.3	0.1
Long-term interest rate ²	2.0	1.5	0.7	0.4	0.6	1.0

¹ According to Maastricht definition. - ² 10-year central government bonds (benchmark).

Table 2: **Productivity**

	2013	2014	2015	2016	2017	2018
					Forecast	
					Percentage changes from previous year	
Total economy						
Real GDP	+ 0.1	+ 0.6	+ 1.0	+ 1.5	+ 1.5	+ 1.4
Hours worked ¹	- 0.6	+ 0.3	- 0.6	+ 0.7	+ 0.7	+ 0.6
Productivity²	+ 0.7	+ 0.3	+ 1.6	+ 0.8	+ 0.8	+ 0.8
Employment ³	+ 0.5	+ 1.0	+ 0.7	+ 1.2	+ 1.0	+ 0.9
Manufacturing						
Production ⁴	+ 0.3	+ 1.6	+ 1.8	+ 2.0	+ 2.3	+ 2.3
Hours worked ⁵	- 1.1	- 0.0	+ 0.3	+ 0.8	+ 0.6	+ 0.3
Productivity²	+ 1.4	+ 1.6	+ 1.5	+ 1.2	+ 1.7	+ 2.0
Employees ⁶	- 0.6	+ 0.3	+ 0.7	+ 0.9	+ 0.5	+ 0.3

¹ Total hours worked by persons employed according to National Accounts definition. – ² Production per hour worked. – ³ Employees and self-employed according to National Accounts definition (jobs). – ⁴ Gross value added, volume. – ⁵ Total hours worked by employees. – ⁶ According to National Accounts definition (jobs).

Table 3: **Private consumption, income and prices**

	2013	2014	2015	2016	2017	2018
	Forecast					
	Percentage changes from previous year, volume					
Private consumption expenditure ¹	-0.1	-0.3	-0.0	+1.5	+1.2	+1.1
Durable goods	-3.0	+0.1	-0.6	+3.2	+2.0	+1.0
Non-durable goods and services	+0.2	-0.3	+0.1	+1.3	+1.1	+1.1
Household disposable income	-1.9	-0.1	+0.3	+2.5	+1.4	+1.4
	As a percentage of disposable income					
Household saving ratio						
Including adjustment for the change in pension entitlements	7.0	7.0	7.3	8.3	8.5	8.8
Excluding adjustment for the change in pension entitlements	6.2	6.4	6.7	7.6	7.8	8.1
	Percentage changes from previous year					
Direct lending to domestic non-banks						
End of period	-1.2	+0.3	+2.0	+1.9	+1.7	+1.3
	Percent					
Inflation rate						
National	2.0	1.7	0.9	0.9	1.7	1.7
Harmonised	2.1	1.5	0.8	0.9	1.7	1.7
Core inflation ²	2.3	1.9	1.7	1.4	1.6	1.6

¹ Private households including non-profit institutions serving households. – ² Excluding energy and unprocessed food (meat, fish, fruits, vegetables).

Table 4: **Earnings, international competitiveness**

	2013	2014	2015	2016	2017	2018
					Forecast	
					Percent changes from previous year	
Wages and salaries per employee¹						
Nominal, gross	+ 1.9	+ 1.7	+ 1.7	+ 1.4	+ 1.6	+ 1.8
Real²						
Gross	- 0.1	- 0.0	+ 0.8	+ 0.5	- 0.1	+ 0.1
Net	- 0.6	- 0.6	+ 0.2	+ 3.0	- 0.2	- 0.3
Wages and salaries per hour worked¹						
Real², net	+ 0.3	- 0.2	+ 1.7	+ 3.5	+ 0.3	+ 0.2
					In %	
Wage share, adjusted³	68.6	70.2	69.5	69.0	69.1	69.1
					Percent changes from previous year	
Unit labour costs⁴, nominal						
Total economy	+ 2.1	+ 1.8	+ 1.7	+ 1.2	+ 1.3	+ 1.5
Manufacturing	+ 2.2	+ 0.9	+ 1.2	+ 1.0	+ 0.2	+ 0.1
Effective exchange rate - industrial goods⁵						
Nominal	+ 1.8	+ 1.2	- 2.7	+ 1.1	- 0.1	+ 0.1
Real	+ 2.2	+ 1.5	- 2.7	+ 1.2	- 0.3	- 0.2

¹ According to National Accounts definition. – ² Deflated by CPI. – ³ Compensation of employees in relation to national income, adjusted for the change in the share of employees in total employment compared to the baseyear 1995. – ⁴ Labour costs in relation to productivity (Compensations of employees per employees' hour worked in relation to GDP per employed persons' hour worked). –

⁵ Weighted by export and import, volume measured by HCPI.

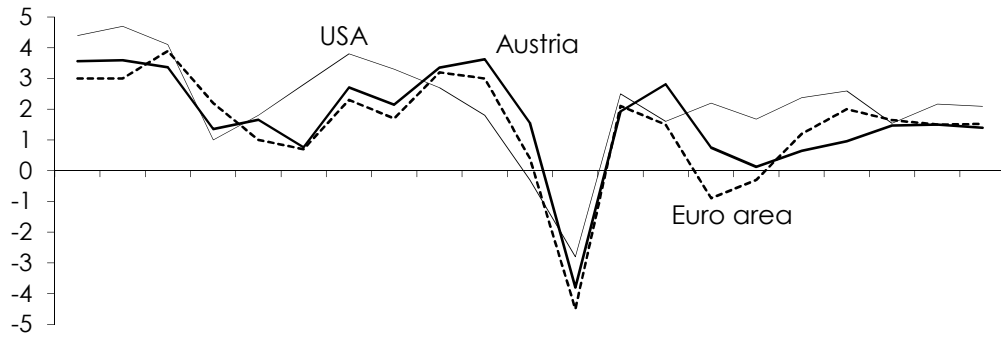
Table 5: Labour market

	2013	2014	2015	2016	2017	2018
	Forecast					
	Changes from previous year (1,000s)					
Demand for labour						
Persons in active employment ¹	+ 29.2	+ 31.8	+ 41.0	+ 57.0	+ 47.0	+ 41.0
Employees ^{1,2}	+ 21.2	+ 23.8	+ 33.2	+ 52.0	+ 42.0	+ 36.0
National employees	- 8.5	- 8.1	+ 6.3	+ 17.0	+ 9.0	+ 6.0
Foreign employees	+ 29.7	+ 32.0	+ 27.0	+ 35.0	+ 33.0	+ 30.0
Self-employed ³	+ 8.0	+ 8.0	+ 7.8	+ 5.0	+ 5.0	+ 5.0
Labour supply						
Population of working age (15-64)	+ 23.5	+ 33.1	+ 52.3	+ 68.9	+ 42.0	+ 35.3
Labour force ⁴	+ 55.8	+ 64.0	+ 76.0	+ 60.5	+ 63.0	+ 53.0
Surplus of labour						
Unemployed ⁵	+ 26.6	+ 32.2	+ 35.0	+ 3.5	+ 16.0	+ 12.0
Unemployed persons in training	+ 6.9	+ 1.8	- 10.2	+ 2.1	+ 6.0	+ 3.0
	Percent					
Unemployment rate						
As a percentage of total labour force (Eurostat) ⁶	5.4	5.6	5.7	6.1	6.2	6.2
As a percentage of total labour force ⁵	6.8	7.4	8.1	8.1	8.3	8.5
As a percentage of dependent labour force ⁵	7.6	8.4	9.1	9.1	9.3	9.5
	Percentage changes from previous year					
Labour force ⁴	+ 1.4	+ 1.5	+ 1.8	+ 1.4	+ 1.5	+ 1.2
Persons in active dependent employment ^{1,2}	+ 0.6	+ 0.7	+ 1.0	+ 1.5	+ 1.2	+ 1.0
Unemployed ⁵	+ 10.2	+ 11.2	+ 11.0	+ 1.0	+ 4.5	+ 3.2
Level in 1,000	287.2	319.4	354.3	357.8	373.8	385.8

¹ Excluding parental leave and military service. – ² According to the Organisation of Austrian Social Security. – ³ According to WIFO, including free professions and unpaid family workers. – ⁴ Persons in active employment plus unemployed. – ⁵ According to Public Employment Service Austria. – ⁶ Labour Force Survey.

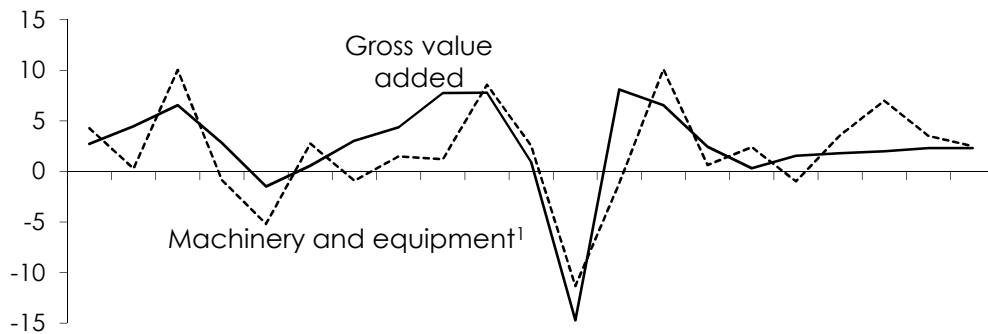
Growth of real GDP

Percent



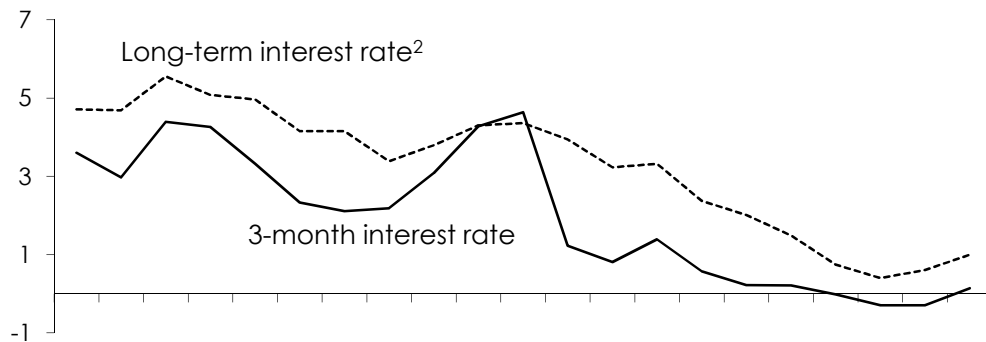
Manufacturing and investment

Percentage changes from previous year, volume



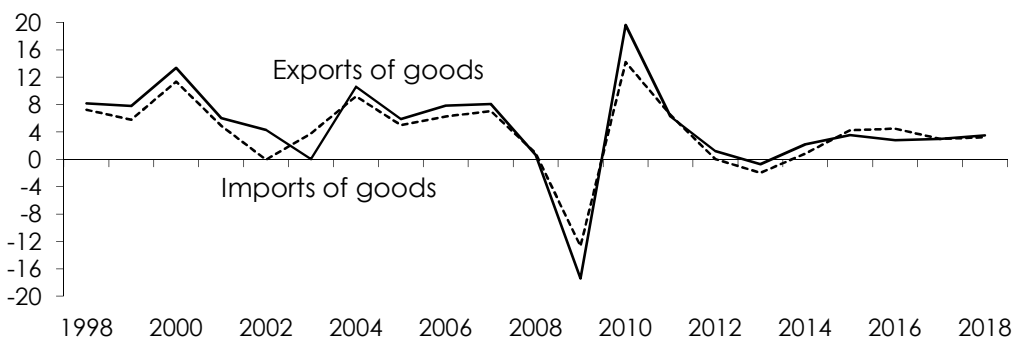
Short-term and long-term interest rates

Percent



Trade according to National Accounts

Percentage changes from previous year, volume

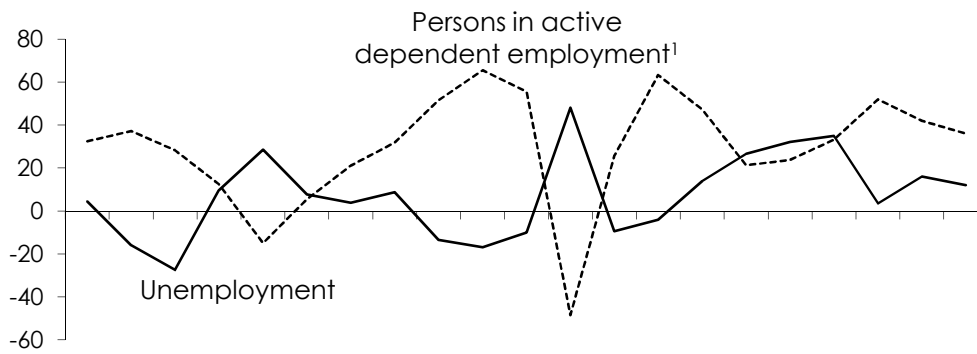


¹ Including weapons systems.

² 10-year central government bonds (benchmark).

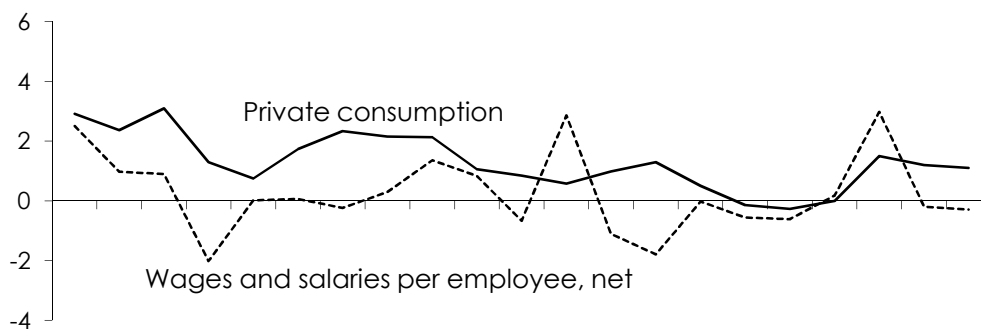
Employment and unemployment

1,000^s from previous year



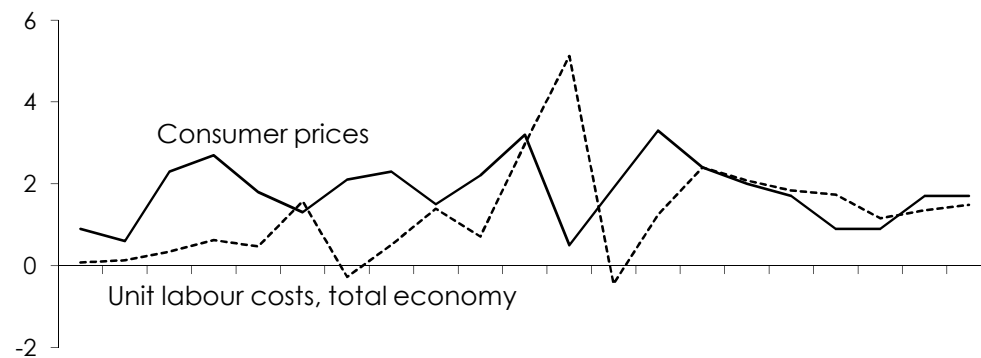
Consumption and income

Percentage changes from previous year, volume



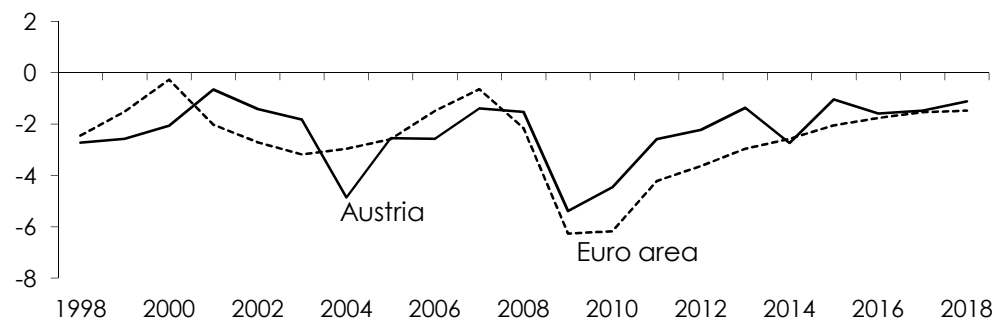
Inflation and unit labour costs

Percentage changes from previous year



General government financial balance

As a percentage of GDP



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