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Tentative, But Fragile Recovery

Economic Outlook for 2014 to 2016

Tentative, But Fragile Recovery. Economic Outlook for 2014 to 2016
After the stagnation prevailing since spring 2014, economic activity in Austria will remain subdued also in early 2015. Leading indicators have lately given no firm hopes for a cyclical rebound. From a short-term perspective, the conditions for a normal recovery of demand and output in Austria are hardly in place. Developments may turn more favourable only in 2016, when the weaker euro exchange rate, low commodity prices and a pick-up in global activity will give fresh momentum to the domestic economy. Austria's real GDP is projected to grow by 0.4 percent in 2014, 0.5 percent in 2015 and 1.1 percent in 2016.

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Business activity in Austria lost considerable momentum in the second and third quarter 2014, ending in stagnation. After having grown substantially in the third and fourth quarter 2013, seasonally- and calendar-adjusted real GDP remained flat. Growth in Austria is likely to resume only gradually, with no firm improvement to be expected until spring 2015. On the other hand, there are no signs for the economy slipping back into recession.

Whether the Austrian economy will regain strength during 2015 will depend not only on efforts at structural adjustments and a tax reform at the national level, but also on the international environment. If the recovery in the euro area progresses as expected and world trade picks up again, the domestic economy will also receive incentives for stronger growth. Since the Austrian corporate sector features on the whole a moderate debt burden and healthy price-cost relations and supplies key foreign markets with an attractive product mix, it should be able to take advantage of the opportunities offered by a recovery abroad. This should generate positive spillovers for private investment, given the continuing favourable financing conditions. GDP growth for 2015 will nevertheless turn out only marginally higher than in 2014, taking the period of sluggish activity into its fourth year. Growth is expected to gradually gain momentum only by 2016[1].

[1] The projections have for the first time been based upon ESA 2010 (for methodological changes to the National Accounts and their implications see i.a. the latest publications by Statistics Austria).

Despite the only moderate pick-up of growth over the forecast horizon, the rate of inflation should remain subdued. This is due to cheap energy commodities on the one hand, and to the expectation that the output gap will not have closed by the end of 2016, on the other. From a rate of 1.6 percent in 2014, headline inflation is projected to barely move to 1.5 percent in 2015 and 1.6 percent in 2016. The public sector is expected to be a major driver of inflation over the entire forecast period, via administered prices and indirect taxes. Next to steady, but moderate growth of private consumption, investment should pick up over the next two years. Employment and labour supply will both stay on an upward trend, but with business activity still slack, unemployment will keep rising despite new jobs being created. The contribution of foreign trade to GDP growth is likely to be slightly negative during the forecast period. In view of sluggish activity in the euro area that takes up around 50 percent of Austrian exports, a lasting recovery of the latter should not yet be expected.

Table 1: Main results

		2011	2012	2013	2014	2015	2016
		Percentage changes from previous year					
GDP							
Volume		+ 3.1	+ 0.9	+ 0.2	+ 0.4	+ 0.5	+ 1.1
Value		+ 4.9	+ 2.8	+ 1.7	+ 2.2	+ 2.3	+ 2.5
Manufacturing[1], volume		+ 9.0	+ 1.1	+ 0.6	+ 0.2	+ 1.0	+ 2.1
Wholesale and retail trade, volume		+ 3.6	– 0.1	– 1.6	– 1.0	± 0.0	+ 0.5
Private consumption expenditure, volume		+ 0.7	+ 0.6	– 0.1	+ 0.2	+ 0.4	+ 0.7
Gross fixed investment, volume		+ 6.8	+ 0.5	– 1.5	+ 1.4	+ 1.1	+ 1.3
Machinery and equipment		+ 9.8	– 0.6	– 1.5	+ 1.5	+ 1.5	+ 2.0
Construction		+ 2.6	+ 1.2	– 2.2	+ 1.2	+ 0.7	+ 0.5
Exports of goods[2]							
Volume		+ 7.1	+ 0.6	+ 2.8	+ 1.2	+ 2.5	+ 3.5
Value		+ 11.3	+ 1.5	+ 1.8	+ 0.7	+ 1.5	+ 4.2
Imports of goods[2]							
Volume		+ 8.3	– 0.9	+ 0.2	+ 0.9	+ 2.5	+ 2.8
Value		+ 15.3	+ 0.7	– 1.0	– 0.6	+ 1.0	+ 4.1
Current balance	billion €	+ 5.06	+ 4.73	+ 3.32	+ 3.20	+ 3.22	+ 2.70
As a percentage of GDP		+ 1.6	+ 1.5	+ 1.0	+ 1.0	+ 1.0	+ 0.8
Long-term interest rate[3]	percent	3.3	2.4	2.0	1.5	1.2	1.2
Consumer prices		+ 3.3	+ 2.4	+ 2.0	+ 1.6	+ 1.5	+ 1.6
Unemployment rate							
Eurostat definition[4]	percent	4.2	4.3	4.9	5.0	5.3	5.3
National definition[5]	percent	6.7	7.0	7.6	8.4	8.9	9.3
Persons in active dependent employment[6]		+ 1.9	+ 1.4	+ 0.6	+ 0.7	+ 0.4	+ 0.6
General government financial balance according to Maastricht definition							
As a percentage of GDP		– 2.6	– 2.3	– 1.5	– 3.0	– 2.4	– 1.9

Source: WIFO. 2014 to 2016: forecast. – [1] Value added, including mining and quarrying. – [2] According to Statistics Austria. – [3] 10-year central government bonds (benchmark). – [4] According to Eurostat Labour Force Survey. – [5] According to Public Employment Service Austria, as a percentage of total labour force excluding self employed. – [6] Excluding parental leave, military service.

In spite of the fragile cyclical conditions, the financial position of the general government is unlikely to deteriorate from the level held in 2013. For 2014, the government deficit (in the Maastricht definition) is expected at 3.0 percent of GDP, narrowing to 2.4 percent and 1.9 percent of GDP in 2015 and 2016, respectively. The budget projections are based upon the assumption that the government will keep fiscal consolidation on track and that any expansionary stimulus will be confined to the operation of automatic stabilisers. Particular budgetary risks on the expenditure side derive from the still uncertain need for financial support to banks in distress that had been nationalised.

1. The starting situation

Activity in Austria has recently been lacking stimulus both domestic and from abroad. Private consumption stagnated, while exports followed a downward trend from the second quarter 2014 onwards. The coincidence of weak orders, receding domestic and foreign final demand and a dull business climate led to restraint on the part of private investors.

During 2014, business activity in Austria lost considerable momentum, disappointing the optimistic expectations cherished last year. Output fell short of projections notably in manufacturing, trade and the credit and insurance business. On the demand side, exports surprised in the negative sense. Despite real disposable incomes remaining flat, a lower savings ratio allowed private consumption to edge up, thereby stabilising final domestic demand at a low level.

The present cyclical weakness is due to a host of factors. The sluggish advance of real incomes offers little scope for additional consumer spending. Persistent sluggish activity in the euro area and the implicit clouding of business confidence are weighing on export growth. Uncertainty surrounding the outlook for domestic and foreign markets is dampening the appetite for business fixed investment. The rekindling of risks, due inter alia to geopolitical turbulence, is another reason for investors' wait-and-see attitude. The moderate pick-up in gross fixed investment that got underway at the turn of the year 2013-14 ended abruptly in spring as the initially very high business expectations were disappointed and repeatedly revised down. With incoming orders stagnating, capacity utilisation in manufacturing did not rise beyond a normal degree, thereby enfeebling a major motive for investment. Also the Austrian housing market is slackening, as the rise in real estate prices is levelling off. Despite favourable weather conditions in the winter months of 2013-14, construction output for the whole of 2014 remained flat, with only the seasonal profile differing from the previous year.

From today's perspective, earlier projections have been too optimistic not only for the global trade outlook, but also for the recovery of the euro area and for part of internal demand. Accordingly, opinion surveys and forecasts in recent months were marked by a substantial degree of disenchantment. While the WIFO forecast of last September had cited the deterioration of economic conditions abroad with a possible impact on business fixed investment as important risk to the projection, the weakening of domestic demand and output growth was not anticipated in full. Expectations proved too optimistic notably for the manufacturing sector (accounting for 20 percent of domestic value added in 2013), trade (13 percent) and the credit and insurance business (4 percent) on the supply side, and for exports among the demand components.

2. External assumptions and the policy framework

Underlying the present forecast stretching from the fourth quarter 2014 to the fourth quarter 2016 are assumptions on the development of global economic activity, of commodity prices, interest rates, exchange rates and the policy framework. They are based on the state of information prevailing in early December 2014.

Global economic activity is likely to strengthen somewhat over the forecast horizon.

Growth of the world economy appears to have gathered pace in the course of 2014, although this has only partly been reflected in the profile of international trade. From a rate of 3.3 percent in 2014, growth of global GDP should edge up to 3.6 percent each in 2015 and 2016, which would still trail markedly behind the trend rate before the crisis. In the industrialised economies, expansionary monetary policy is countervailed by the need for fiscal consolidation, but also the growth potential has diminished. In the emerging market economies, structural impediments as well as financial and macroeconomic imbalances act as constraints to growth. Among the advanced economies, growth is likely to stay buoyant in the USA, thereby remaining a major driver of activity worldwide. The Chinese economy should once again provide strong incentives, albeit to somewhat lesser extent than before the crisis.

Demand and output in the euro area lost momentum during summer 2014. Quarterly growth turned out low and the business outlook clouded further. Negative news came mainly from the core countries, while developments were more favourable in the periphery that had been most severely hit by the crisis. In these countries, the forces of expansion now seem to get the upper hand, displacing the contractionary elements that had dominated the adjustment process. Growth in the euro area core countries, on the other hand, is held back by lingering structural problems and deficient domestic demand. The sluggish expansion of world trade and rising geopolitical tensions are also inhibiting factors. Arguably, activity is set to pick up over the forecast period, fuelled not only by monetary expansion and improving financing conditions, but also by more favourable prospects for international trade and low oil prices; nevertheless, expectations for growth over the next two years are revised down markedly in the face of recent sluggishness and the subdued outlook for the months to come. Even with demand and output growth likely to pick up, productive capacities will still not be utilised to normal degree by 2016, and unemployment will hardly recede. Euro area real GDP is expected to grow by slightly over 0.8 percent in 2014, 0.9 percent in 2015 and 1.1 percent in 2016.

Table 2: World economy

	2011	2012	2013	2014	2015	2016
	Percentage changes from previous year					
Real GDP						
World	+ 4.1	+ 3.4	+ 3.3	+ 3.3	+ 3.6	+ 3.6
USA	+ 1.6	+ 2.3	+ 2.2	+ 2.2	+ 3.1	+ 2.8
Japan	– 0.5	+ 1.5	+ 1.5	+ 0.4	+ 0.7	+ 1.2
EU 28	+ 1.7	– 0.4	± 0.0	+ 1.3	+ 1.4	+ 1.5
Euro area 18	+ 1.6	– 0.7	– 0.5	+ 0.8	+ 0.9	+ 1.1
CEEC 5[1]	+ 3.6	+ 0.4	+ 0.1	+ 1.4	+ 0.9	+ 1.2
China	+ 3.3	+ 0.5	+ 1.0	+ 2.9	+ 2.6	+ 2.8
World trade, volume	+ 6.1	+ 2.1	+ 2.7	+ 3.7	+ 4.0	+ 4.1
Market growth[2]	+ 6.1	+ 2.1	+ 2.7	+ 3.7	+ 4.0	+ 4.1
Primary commodity prices[3]						
HWWI index, total	+ 28.6	– 2.8	– 1.9	– 7	– 22	+ 2
Excluding energy	+ 19.2	– 14.4	– 6.1	– 5	– 10	+ 10
Crude oil prices						
Brent, $ per barrel	111.3	111.6	108.7	100	75	90
Exchange rate						
$ per euro	1.392	1.286	1.328	1.32	1.25	1.20

Source: WIFO. 2014 to 2016: forecast. – [1] Czech Republic, Hungary, Poland, Slovakia, Slovenia. – [2] Real import growth of goods of trading partners weighted by Austrian export shares. – [3] Dollar.

Quotations for crude oil, after their rise in June, fell back noticeably in the following months. The prospect of abundant supply that apparently is more resilient to geopolitical tensions than originally feared, goes hand in hand with a slowdown of worldwide demand growth. Nevertheless, oil futures are slightly pointing up for early 2015 and beyond. Other commodity prices have also eased since the forecast revision of last September, implying a year-on-year fall for the annual 2015 figure, followed by an expected rebound with the upturn of the international business cycle.

The assumptions on the economic policy framework have not changed substantially from the forecast of last September.

The present projections take on board those government measures that have either been adopted already or have been sufficiently specified and are likely to be actually implemented. Accordingly, any potential effects on the real economy deriving from an income tax reform in Austria or from the growth-enhancing investment "package" lately decided at EU level have not been included. While for the latter the planned overall scope has been specified, crucial details concerning the allocation of the financial resources are still unclear. For 2015, any such effects on growth are likely to be marginal, notably if a substantial part of the funds were to be devoted to large-scale projects.

3. Outlook for the Austrian economy

GDP growth is projected to stay below its long-term average also in 2015, taking the sluggishness prevailing since 2012 into its fourth year.

Economic growth in Austria is expected to only gradually regain momentum. No substantial improvement is as yet visible for the fourth quarter 2014 and the first quarter 2015. On the other hand, there are no signs for the economy slipping back into recession. Except for the fall in energy commodity prices, the last months have seen no major macroeconomic shock that would invalidate the assumptions underlying the forecast of last September: incentives for stronger growth have been lacking worldwide, and domestic industrial orders have been a reflection of the lacklustre investment activity. Against this background, real GDP fell slightly in the third quarter 2014, by 0.1 percent from the previous period, with the downward trend likely to continue into early 2015. For the whole year 2014, the positive carry-over from 2013 will nevertheless yield a positive growth rate of 0.4 percent or above. The slackening pace in the course of the year will, for its part, generate a small negative statistical carry-over for 2015.

3.1 Leading indicators signal further sluggish business activity ahead

The short-term business outlook remains depressed, as confirmed by the latest readings of most leading indicators. The regular WIFO Business Cycle Survey of last November showed little change from the previous month. For the whole economy, assessments of the current situation closed with a negative balance of 1.3 points, significantly down from one month before as well as from the average for the earlier years. Adverse developments in the services sector were responsible for the fall, while the index headed up for the construction and the manufacturing business.

Business expectations picked up somewhat in November from one month earlier, for the second time in a row. Both manufacturers and construction firms were slightly more confident than in October, although the partial index for the construction sector remains in the negative range.

The Purchasing Managers' Index compiled by Bank Austria also points to lasting cyclical weakness. Although the index has edged up most recently, it is still clearly below the threshold readings above which would signal expansion.

The WIFO Leading Indicator, while remaining downward bound, is showing a tendency towards bottoming out, giving hope for a turnaround at the beginning of 2015.

The Business Barometer developed by the Austrian Economic Chamber (WKO) indicated at the end of November a significant weakening of business expectations for 2015, pointing to lacklustre activity for most of 2015.

The general picture conveyed by the indicators leads to the conclusion that the current cyclical downswing will flatten off. A turning point may have been reached by the beginning of the second quarter 2015.

From the current "soft patch", economic growth is unlikely to resume before 2016.

Also for 2015, current leading indicators give no firm hints to a cyclical recovery. From a short-term perspective, the conditions for a gradual upturn of demand and output in Austria are hardly in place. After the subdued expansion since the beginning of 2014, the economy is likely to remain, if at all, on a slow-growth track. Accordingly, the cyclical pattern over the projection period, as illustrated in Figure 2, is one of sluggish activity throughout 2015, with quarterly GDP growth rates tentatively picking up only as from the second half of 2015 and in 2016.

A quarterly pattern as inferred in Figure 2 would yield annual GDP growth rates of 0.4 percent for 2014, 0.5 percent for 2015 and 1.1 percent for 2016, implying underutilised productive capacities over the entire forecast period. The latter assessment is based on a recalculation of potential output[2]. A normal degree of capacity utilisation will not be reached within the forecast horizon. By 2016, GDP growth is ex-

[2] Details are presented in Baumgartner, J., Kaniovski, S., Pitlik, H., "Wirtschaftswachstum weiterhin verhalten, Arbeitslosigkeit bleibt hoch. Mittelfristige Prognose der österreichischen Wirtschaft bis 2019", WIFO-Monatsberichte, 2015, 88(1), pp. 51-66, http://monatsberichte.wifo.ac.at/50923.

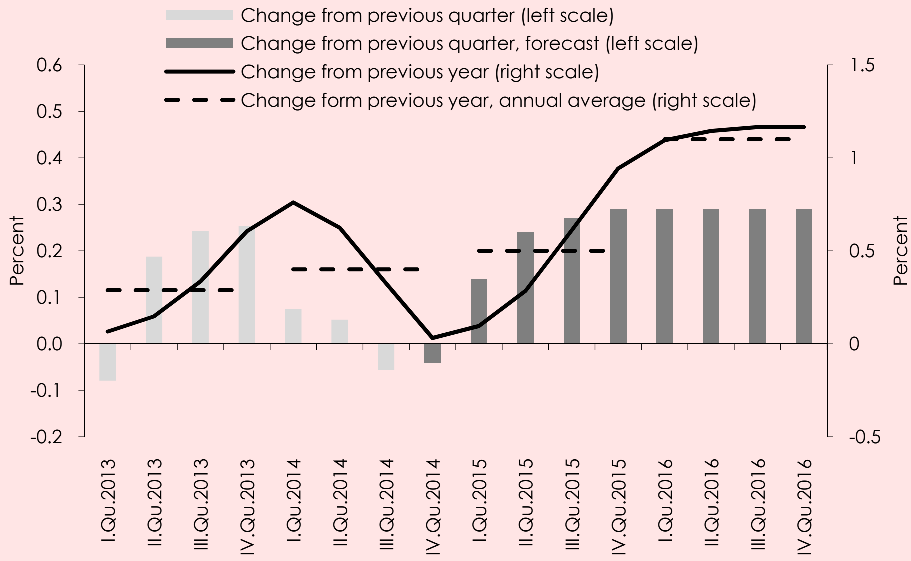
pected to nearly match the rate of potential output growth, such that capacity slack will barely increase further.

As a result of the high overhang from the earlier period, in combination with the slow pace during the year, the annual rate of GDP growth for 2014 was entirely "generated" in the previous year. In 2015, these two effects will work in the opposite direction, i.e. a carry-over of almost zero is coupled with a projected high growth rate of 0.9 percent during the year (Table 3). Should the latter prove unrealistic already in spring, the projected annual GDP growth of 0.5 percent for 2015 would appear optimistic altogether.

Figure 1: Indicators of economic performance

Source: WIFO. 2014 to 2016: forecast. – [1] Excluding parental leave, military service, and unemployed persons in training. – [2] 10-year central government bonds (benchmark).

Figure 2: Cyclical profile for Austria



Source: WIFO.

Table 3: Technical assumptions for the GDP growth projection

		2013	2014	2015	2016
Carry-over[1]	percentage points	+ 0.0	+ 0.4	– 0.0	+ 0.4
Growth during the year[2]	percentage changes from previous year	+ 0.6	+ 0.0	+ 0.9	+ 1.2
Annual average	percentage changes from previous year	+ 0.2	+ 0.4	+ 0.5	+ 1.1

Source: WIFO. 2014 to 2016: forecast. – [1] Annual rate of change, if GDP for the current year remains constant at the level of the fourth quarter of the previous year, adjusted for seasonal and calendar effects. – [2] Year-on-year rate of change in the fourth quarter, adjusted for seasonal and calendar effects.

From the projection of last September, growth expectations for 2014 and 2015 have thus once again been revised down. While the correction of the annual rate for 2014 can by and large be explained by forecast errors already occurred during the year, the revision for 2015 is motivated by a more cautious judgement on growth prospects. Moreover, the external environment was less favourable in 2014, requiring a substantial markdown from earlier assumptions on export market growth.

A strengthening of export growth is the precondition for the projected growth path actually materialising.

A crucial condition for this path of GDP growth materialising is a pickup in export growth. After 0.2 percentage points in 2014, the growth contribution of exports is set to increase markedly in the years to come. With the assumed rebound in world trade and the strengthening recovery in the euro area, export growth should accelerate from 1.9 percent in 2015 to 2.8 percent in 2016.

Higher exports have to be set against the strong increase in imports expected over the forecast period. The net contribution of foreign trade to GDP growth is therefore projected to be slightly negative.

3.2 Corporate investment continuing to contribute only little to GDP growth

Despite persistently low interest rates, investment will remain below its long-term trend.

Due to the initially modest revival of manufacturing activity, corporate investment is set to gather pace only in the course of 2015. In the absence of further disturbances to the investment climate, the brightening of sales prospects and rising capacity utilisation should stimulate demand for new machinery, equipment and commercial building. Financing conditions remain highly favourable and are conducive to the normalisation of productive capital formation. Yet, the low interest rates will not by themselves trigger an investment boom in Austria: given the weak business climate, low order levels and poor sales expectations, firms will proceed with caution in creating new production capacity.

Indeed, firms will mainly seek to replace obsolete equipment rather than embarking on enlargement of their production facilities. This carries the risk that in the event of a cyclical upturn, possibly setting in earlier than expected, Austrian firms may not fully benefit from it, because of investment opportunities missed during the past years. In such a situation, even circumstances conducive to investment like the important stock of liquid corporate assets will not deploy their full effect.

3.3 Inflation in Austria continues to markedly exceed the euro area average

Austrian headline inflation is projected to remain above the average for the euro area. Real earnings may thus continue to decline slightly despite rather generous settlements for contractual wages.

The critical situation on the labour market and the moderate expansion of employees' hours worked put a lid on the increase in per-capita wages. The latter, at rates of 1.5 percent both in 2014 and 2015 and 1.6 percent in 2016 in nominal gross terms, will turn out lower than in 2012 and 2013. Although the rate of inflation has abated somewhat in 2014, it still remains high in view of the cyclical slack and compared with the euro area average.

Table 4: Earnings and international competitiveness

	2011	2012	2013	2014	2015	2016
	Percentage changes from previous year					
Gross earnings per employee[1]	+ 1.8	+ 2.7	+ 1.7	+ 1.5	+ 1.5	+ 1.6
Gross real earnings per employee[2]	− 1.4	+ 0.2	− 0.3	− 0.1	± 0.0	± 0.0
Net real earnings per employee[2]	− 1.7	− 0.2	− 0.7	− 0.6	− 0.5	− 0.5
Unit labour costs						
Total economy	+ 0.5	+ 2.9	+ 2.4	+ 2.7	+ 1.6	+ 1.2
Manufacturing	− 3.2	+ 3.7	+ 1.8	+ 1.3	+ 0.6	− 0.3
Effective exchange rate, manufactures						
Nominal	+ 0.1	− 1.7	+ 1.8	+ 1.1	− 1.0	− 0.5
Real	+ 0.5	− 1.7	+ 2.1	+ 1.3	− 1.1	− 0.9

Source: WIFO. 2014 to 2016: forecast. – [1] Employees according to National Accounts definition. – [2] Deflated by CPI.

Table 5: Private consumption, income and prices

	2011	2012	2013	2014	2015	2016
	Percentage changes from previous year					
Private consumption expenditure	+ 0.7	+ 0.6	− 0.1	+ 0.2	+ 0.4	+ 0.7
Durables	+ 4.6	− 0.1	− 3.2	− 0.5	+ 0.5	+ 1.5
Non-durables and services	+ 0.3	+ 0.7	+ 0.2	+ 0.3	+ 0.4	+ 0.6
Household disposable income	− 1.1	+ 1.9	− 2.1	− 0.0	+ 0.5	+ 1.0
	As a percentage of disposable income					
Household saving ratio[1]	7.8	9.0	7.3	7.1	7.1	7.4
Household saving ratio[2]	7.1	8.3	6.5	6.3	6.3	6.6
	Percentage changes from previous year					
Direct lending to domestic non-banks[3]	+ 2.7	+ 0.0	− 1.2	+ 0.5	+ 1.0	+ 1.2
	Percentage changes from previous year					
Inflation rate						
National	3.3	2.4	2.0	1.6	1.5	1.6
Harmonised	3.6	2.6	2.1	1.5	1.4	1.6
Core inflation[4]	2.8	2.3	2.3	1.9	1.8	1.5

Source: WIFO. 2014 to 2016: forecast. – [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.

The technical assumptions for oil prices and exchange rates imply a slightly rising path of oil commodity prices (notably for fuels and heating oil), after their sharp fall in recent months. In this case, the Austrian consumer price index would rise by 1.6 percent in 2014, 1.5 percent in 2015 and 1.6 percent in 2016. Against the forecast of last September, this represents a downward revision by 0.2 and 0.3 percentage points for 2014 and 2015 respectively. The larger part of the revision is due to oil market developments from early August to end of November 2014, and to the domestic cyclical weakness.

Despite the overall moderate inflationary pressure, the increase in the index still markedly exceeds the one recorded for other euro area countries.

The inflation differential between Austria and the euro area average is mainly due to stronger price increases for services and food items in Austria. But also Austria's public sector is a driver of inflation: in 2014, administered prices and hikes of indirect taxes added about ½ percentage point to the increase in the consumer price index, of which ¼ percentage point was the contribution of administered prices like public charges. Apart from the relative strong inflation pressure, private purchasing power is undermined by the rising tax burden via fiscal drag. The progressive income tax schedule translates rather small nominal wage gains into strong increases in wage tax revenues (such as +5.9 percent year-on-year from January to October 2014). Net real per-capita wages, therefore, remain on a downward trend over the entire forecast horizon (2014 –0.6 percent, 2015 –0.5 percent, 2016 –0.5 percent).

In addition, the tight labour market is squeezing private household purchasing power. Against this background, private consumption growth is likely to stay subdued up to the forecast horizon, thereby impairing the prospects for a domestically-driven cyclical upswing.

3.4 Service industries sustaining employment

Growth of GDP is largely generated by productivity advances, while labour input is stagnating for the economy as a whole.

Despite sluggish quarterly GDP growth during 2014 and the clouding short-term outlook, labour market developments promise to remain uneven. As the domestic population of working age diminishes, the increase in labour supply as well as in employment is driven by inflow of foreign labour including cross-border commuters. Furthermore, labour supply in the age group of 50 years and above is rising as a result of strong age cohorts and the restrictions being imposed on early retirement.

Table 6: Labour market

		2011	2012	2013	2014	2015	2016
		Changes from previous year, in 1,000					
Demand for labour							
Persons in active employment[1]		+ 69.9	+ 50.1	+ 27.9	+ 29.0	+ 20.0	+ 25.0
Employees[2]		+ 63.3	+ 47.2	+ 21.2	+ 22.5	+ 15.0	+ 20.0
Percentage changes from previous year		+ 1.9	+ 1.4	+ 0.6	+ 0.7	+ 0.4	+ 0.6
Nationals		+ 25.7	+ 9.0	– 8.5	– 9.5	– 4.0	– 4.0
Foreign workers		+ 37.7	+ 38.1	+ 29.7	+ 32.0	+ 19.0	+ 24.0
Self-employed[3]		+ 6.6	+ 2.9	+ 6.7	+ 6.5	+ 5.0	+ 5.0
Labour supply							
Population of working age	15 to 64 years	+ 31.3	+ 18.0	+ 23.5	+ 28.4	+ 25.5	+ 23.3
	15 to 59 years	+ 11.7	+ 22.3	+ 27.2	+ 28.2	+ 18.7	+ 8.5
Labour force[4]		+ 65.8	+ 64.0	+ 54.5	+ 61.0	+ 43.0	+ 43.0
Surplus of labour							
Registered unemployed[5]		– 4.1	+ 13.9	+ 26.6	+ 32.0	+ 23.0	+ 18.0
In 1,000		246.7	260.6	287.2	319.2	342.2	360.2
Unemployed persons in training[5]	in 1,000	63.2	66.6	73.5	75.0	71.5	71.5
		In percent					
Unemployment rate							
Eurostat definition[6]		4.2	4.3	4.9	5.0	5.3	5.3
As a percentage of total labour force[5]		6.0	6.2	6.8	7.4	7.9	8.2
National definition[5, 7]		6.7	7.0	7.6	8.4	8.9	9.3
Employment rate							
Persons in active employment[1, 8]		66.6	67.2	67.4	67.6	67.7	67.8
Total employment[6, 8]		72.1	72.5	72.3	72.7	72.7	72.8

Source: WIFO. 2014 to 2016: forecast. – [1] Excluding parental leave, military service. – [2] According to Federation of Austrian Social Security Institutions. – [3] According to WIFO. – [4] Persons in active employment plus unemployment. – [5] According to Public Employment Service Austria. – [6] According to Eurostat Labour Force Survey. – [7] As a percentage of total labour force, excluding self-employed. – [8] As a percentage of population of working age (15 to 64 years).

Despite employment remaining upward bound, unemployment will further increase under the impact of strongly expanding labour supply. Having climbed by 0.6 percentage points to 7.6 percent of the dependent labour force in 2013, the unemployment rate (according to the national definition) is projected to ratchet up to 8.4 percent in 2014 and further to 8.9 percent in 2015 and 9.3 percent in 2016.

Job creation is mainly sustained by the services branches. Labour input in manufacturing in 2015 is falling due to a reduction of the workforce as well as a cut in per-capita working hours. For the whole economy, the number of hours worked is likely to remain flat over the forecast period, such that economic growth is entirely driven by gains in productivity.

Table 7: Productivity

	2011	2012	2013	2014	2015	2016
	Percentage changes from previous year					
Total economy						
Real GDP	+ 3.1	+ 0.9	+ 0.2	+ 0.4	+ 0.5	+ 1.1
Hours worked[1]	+ 2.0	− 0.1	− 0.5	− 0.1	− 0.1	± 0.0
Productivity per hour	+ 1.1	+ 1.0	+ 0.7	+ 0.5	+ 0.6	+ 1.1
Employment[2]	+ 1.7	+ 1.1	+ 0.7	+ 1.1	+ 0.6	+ 0.7
Manufacturing						
Production[3]	+ 8.8	+ 1.2	+ 0.7	+ 0.2	+ 1.0	+ 2.1
Hours worked[1]	+ 1.6	+ 1.2	− 0.4	− 1.7	− 0.4	+ 1.6
Productivity per hour	+ 7.0	− 0.1	+ 1.1	+ 1.9	+ 1.4	+ 0.5
Employees[1]	+ 1.9	+ 1.6	− 0.1	− 0.2	− 0.1	± 0.0

Source: WIFO. 2014 to 2016: forecast. – [1] According to National Accounts definition. – [2] Dependent and self-employed according to National Accounts definition. – [3] Value added, volume.

4. The risk environment

The present point projections are supplemented by estimates for the margins of uncertainty (Figure 3). Alternative assumptions on external developments (see Table "assumptions on the international economic environment) feed into the risk profile.

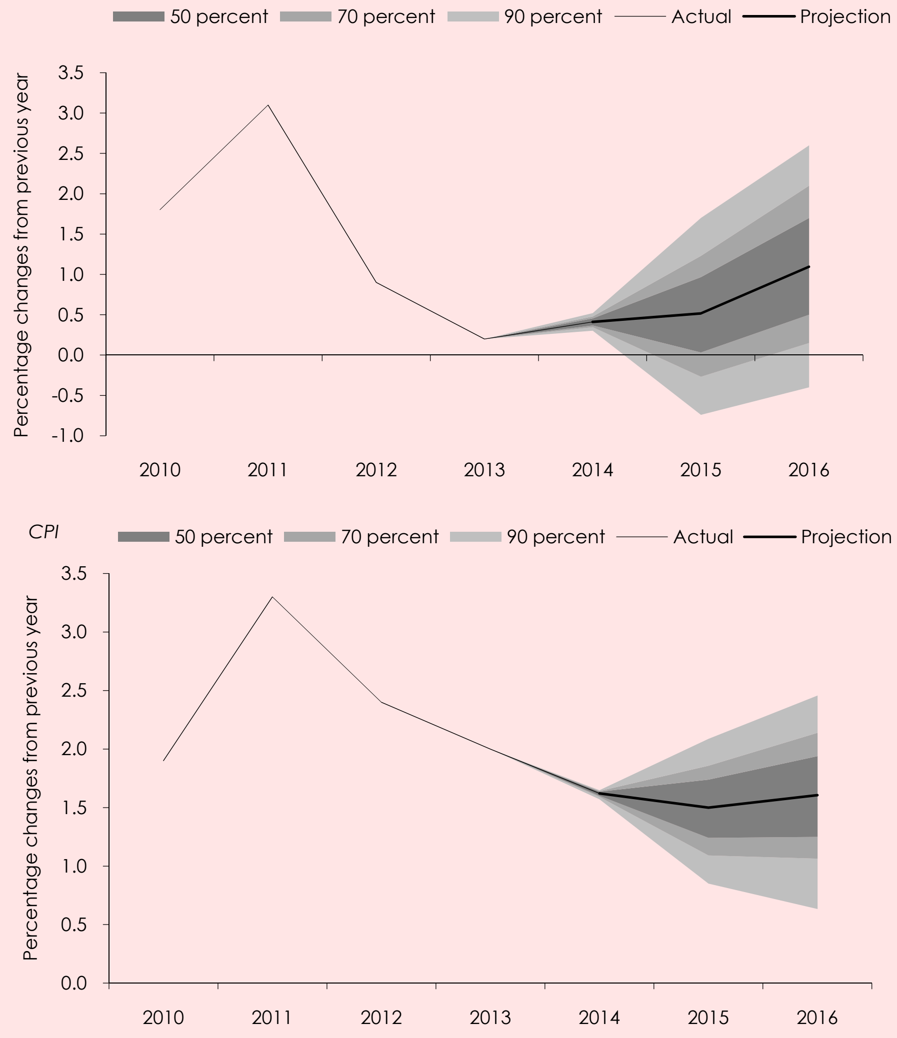
The major risks to the projections of global economic growth derive from a) geopolitical uncertainty with negative repercussions on world markets for commodities and on the real economy; b) financial market disruptions following precipitous price corrections on world stock markets; c) unexpectedly slow growth in key countries and regions. In all these cases, the tight connections of international trade and capital flows may lead to major shocks to the real economy. Experience shows that the Austrian economy, being closely integrated into the international division of labour, suffers early and to an important degree from a setback to economic activity in other regions of the world.

The situation on global financial markets is currently benign and supportive to growth worldwide. Stock markets have been booming recently and risk premia are low, while volatility is muted. Still, these developments are not without risks, as the low interest rates drive many market participants into risky types of investment.

Oil prices fell substantially at the time of the present forecast. External developments hold downward risks to economic growth, notably in case of protracted sluggish activity in the euro area.

Between early and mid-December, at the time when the present forecast was prepared, quotations for crude oil fell once again over the entire term range, on average by 13 percent. Apparently, OPEC does not currently exert its price-stabilising role and eschews cuts of supply quotas. A lasting price decline of such size has potentially strong macroeconomic effects. It instantly lowers the cost of living of private households and companies' cost of production, thereby releasing resources for other uses. Hence, the oil price fall, unless it merely reflects short-term volatility, suggests a downward revision of the inflation forecast and an upward revision of projected GDP growth. If oil prices remain low for an extended period, model calculations would advise to adjust the CPI projection for 2015 even further down. Also in 2016, headline inflation may turn out somewhat lower, though the effect would be much smaller. GDP growth may be up from the present forecast by 0.2 to 0.4 percentage point each for 2015 and 2016. The Austrian economy may benefit even more if global economic activity would likewise be stimulated by the oil price fall.

Figure 3: Margins of uncertainty for the projections of GDP and CPI



Source: WIFO. Based on the posterior distribution of a Bayesian Vector Autoregressive model.

Table 8: Key policy indicators

	2011	2012	2013	2014	2015	2016
	As a percentage of GDP					
Fiscal policy						
General government financial balance						
According to Maastricht definition	− 2.6	− 2.3	− 1.5	− 3.0	− 2.4	− 1.9
General government primary balance	0.1	0.4	1.1	− 0.4	0.2	0.6
	In percent					
Monetary policy						
3-month interest rate	1.4	0.6	0.2	0.2	0.2	0.2
Long-term interest rate[2]	3.3	2.4	2.0	1.5	1.2	1.2
	Percentage changes from previous year					
Effective exchange rate						
Nominal	+ 0.2	− 1.5	+ 1.7	+ 1.1	− 0.9	− 0.6
Real	+ 0.6	− 1.6	+ 2.0	+ 1.3	− 1.0	− 1.0

Source: WIFO. 2014 to 2016: forecast. – [1] 10-year central government bonds (benchmark).

Unlike with earlier forecasts, the current outlook also holds important domestic risks for GDP growth. One of them relates to the current debate over an income tax reform in Austria. A reduction of the tax burden as such would constitute an upward risk for growth. However, the counter-financing of the tax cut carries an important downside risk: the currently envisaged increase in the VAT rate on certain goods currently subject to a reduced rate may weigh on output while raising the CPI.

Domestic elements of uncertainty originate mainly from the course of economic policy, with upward and downward risks roughly evening out.

Next to factors relating to government revenue, also expenditure plans add to forecast uncertainty. A recently discussed construction project as well as the European Growth Initiative already adopted by the European Commission constitute major upward risks for the present growth projection. Quantifying these risks is complicated by the lack of information at this early stage. Should, on the other hand, the tax cuts be counter-financed in part by expenditure reductions, the net impact on growth may be negative, depending on the categories of government spending affected by such restraint.