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Continued Strong Growth Amidst a Riskier Environment

Economic Outlook for 2018 and 2019

Continued Strong Growth Amidst a Riskier Environment. Economic Outlook for 2018 and 2019
After the strong expansion in the previous year, demand and output in Austria should maintain a similar pace in 2018, with GDP growth expected at 3.2 percent. Leading indicators nevertheless foreshadow an increasing slowdown in momentum. GDP growth will be noticeably weaker in 2019 (+2.2 percent). Heightened uncertainty concerning the external policy environment amplifies the downward risks from the economic outlook of March 2018.

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Austria's economy currently enjoys the second year of cyclical boom. Real GDP is expected to gain 3.2 percent in 2018, up from +3.0 percent last year. Despite buoyant investment activity, the high degree of productive capacity utilisation is set to increase further, exacerbating constraints to output growth that have started to emerge. Leading indicators suggest that the cyclical upswing may have reached its turning point and that growth will decelerate over the forecast period. Hence, annual GDP growth for 2019 is projected to abate to +2.2 percent.

Since last year, the pace of expansion exceeds the growth of trend output. Thus, the already positive output gap may widen further in 2019. The implicit inflationary pressure manifested itself in 2017 mainly for industrial goods and, together with higher energy prices, drove consumer prices up by 2.1 percent. The present upward revision of the inflation outlook for 2018 and 2019 mirrors the unexpectedly strong increase in crude oil prices. The consumer price index (CPI) is expected to rise by 2.0 percent in both 2018 and 2019.

Growth of Austria's GDP is broadly based, sustained both by domestic and foreign demand. Among the domestic demand components, investment in machinery and equipment and private consumption are the key drivers. The current investment cycle had started in 2015 and was in its early stages confined mainly to the replacement of productive capital. With bottlenecks increasingly arising, capacity-enhancing investment is now playing the major role. Indeed, the latest Economic Barometer issued by the Austrian Economic Chambers points out that the intention to make capacity expanding investments remains very high among companies.

Next to domestic demand, exports should further contribute to GDP growth, although the momentum may weaken somewhat in line with business conditions abroad. Although the upturn in the global economy remains intact, increasing capacity bottlenecks in many countries on the one hand and a general deterioration in sentiment due to mounting risks on the other will dampen growth rates.

Table 1: Main results

		2014	2015	2016	2017	2018	2019
		Percentage changes from previous year					
Gross domestic product, volume		+ 0.8	+ 1.1	+ 1.5	+ 3.0	+ 3.2	+ 2.2
Manufacturing		+ 2.5	+ 0.6	+ 1.3	+ 6.8	+ 7.8	+ 3.4
Wholesale and retail trade		+ 2.7	+ 3.1	+ 1.4	+ 2.5	+ 2.9	+ 2.8
Private consumption expenditure[1], volume		+ 0.3	+ 0.5	+ 1.5	+ 1.4	+ 1.8	+ 1.8
Consumer durables		– 1.0	+ 2.8	+ 3.3	+ 0.8	+ 2.0	+ 1.5
Gross fixed capital formation, volume		– 0.7	+ 1.2	+ 3.7	+ 4.9	+ 4.1	+ 2.8
Machinery and equipment[2]		– 1.6	+ 1.5	+ 8.6	+ 8.2	+ 7.3	+ 4.2
Construction		– 0.1	+ 1.1	+ 1.1	+ 2.6	+ 2.0	+ 1.4
Exports, volume		+ 3.0	+ 3.1	+ 1.9	+ 5.6	+ 5.3	+ 4.0
Exports of goods		+ 2.9	+ 3.1	+ 1.3	+ 6.1	+ 6.3	+ 4.8
Imports, volume		+ 2.9	+ 3.1	+ 3.1	+ 5.7	+ 4.8	+ 4.0
Imports of goods		+ 2.1	+ 3.7	+ 3.2	+ 5.1	+ 5.2	+ 4.2
Gross domestic product, value		+ 2.8	+ 3.4	+ 2.6	+ 4.6	+ 4.9	+ 4.2
	billion €	333.06	344.49	353.30	369.69	387.81	403.96
Current account balance	as a percentage of GDP	2.5	1.9	2.1	1.9	1.8	1.9
Consumer prices		+ 1.7	+ 0.9	+ 0.9	+ 2.1	+ 2.0	+ 2.0
Three-month interest rate	percent	0.2	– 0.0	– 0.3	– 0.3	– 0.3	– 0.2
Long-term interest rate[3]	percent	1.5	0.7	0.4	0.6	0.8	1.1
General government financial balance, Maastricht definition	as a percentage of GDP	– 2.7	– 1.0	– 1.6	– 0.7	– 0.1	0.2
Persons in active dependent employment[4]		+ 0.7	+ 1.0	+ 1.6	+ 2.0	+ 2.0	+ 1.2
Unemployment rate							
Eurostat definition[5]		5.6	5.7	6.0	5.5	5.1	5.0
National definition[6]		8.4	9.1	9.1	8.5	7.6	7.2

Source: WIFO. 2018 and 2019: 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.

On the Austrian labour market, the recent positive trend should persist over the forecast period. The number of persons in active dependent employment is expected to increase by 2.0 percent in 2018, slowing down slightly in 2019 with the slackening of economic activity. As labour supply is set to expand markedly over the entire projection horizon, the decline in unemployment will be comparatively modest. The unemployment rate (according to national definition) will ease from 8.5 percent of the dependent labour force in 2017 to 7.6 percent in 2018 and 7.2 percent in 2019.

1. The starting situation

The Austrian economy lately received strong stimulus from domestic demand and foreign trade. Growth was driven by buoyant private household consumption, together with firms' higher readiness to invest. Net exports also provided an overall positive contribution to GDP growth.

In 2017, demand and output in Austria expanded by 3.0 percent in volume year-on-year, the highest growth rate in the last six years. Also in early 2018, the economy broadly maintained the pace of the four previous quarters, thereby prolonging the cyclical boom. From the year-earlier period, GDP (unadjusted) rose by 3.4 percent in the first quarter.

The business cycle upturn rests on a broad base as it is supported by both domestic demand and foreign trade. While private consumption proved to be a reliable source of expansion throughout 2017 despite the fading incentives from the tax reform 2015-16, private companies also stepped up their investment. Exports benefitted from lively demand abroad, even if the momentum slackened somewhat in the first quarter of 2018.

On the supply side, the widening base of the upswing is mirrored by considerably accelerating activity in cyclically-sensitive sectors. These are the manufacturing sector and closely related sectors such as wholesale and retail trade and other business services, and the financial sector.

Private incomes also gained substantially in 2017. The increase in wage earnings (compensation of employees) of 3.5 percent year-on-year is a reflection of the sustained increase in nominal wages and of dependent employment. Income from capital (gross operating surplus and mixed income) advanced by 6.6 percent in 2017, markedly exceeding the growth rates of the previous years.

In line with lively output growth, the domestic labour market improved steadily. Job creation gathered further pace in 2017 and led to a significant retreat of unemployment.

2. The external environment

The present projection includes information on the trends in the global economy, commodity prices, exchange and interest rates up to mid-June 2018. The forecast horizon stretches from the second quarter of 2018 to the fourth quarter of 2019.

2.1 Gentle slowdown of global growth expected

Although leading indicators for the emerging market economies have recently weakened, growth should be affected only to a minor extent in the countries concerned. One reason is the virtual absence of capacity constraints to output growth, another the benefit that the commodity exporting emerging countries in particular are drawing from the current rise in raw material prices.

In 2017, the world economy expanded at a rhythm of 3.7 percent, much in line with expectations. From this highest growth rate observed in the last six years, business conditions have eased somewhat in the last months. While the forces driving the global upswing are still operating, they may gradually soften from now on, as foreshadowed by the latest CPB data for industrial production and merchandise trade. Likewise, leading indicators signal a slackening of global economic growth; indeed, the Markit Global Purchasing Managers' Index for the manufacturing sector has moved from an all-time high to a downward trend since the turn of the year.

Output has lately increased overall in the emerging market economies, but growth has been uneven across countries. Hence, the pace of Chinese growth has been little affected by the withdrawal of fiscal stimulus and a tightening of monetary policy. Growth has rebounded in India, after having been dampened by the introduction of a number of policy reforms last year. Brazil has recovered from deep recession, and growth has resumed also in Russia, even if the momentum has so far been subdued in both countries.

In the majority of the industrialised countries, the cyclical upswing has passed its peak. Business confidence has clouded markedly in the last months, possibly also in response to mounting policy uncertainty in the USA. A countervailing force is the move towards greater fiscal expansion in a number of countries, particularly in the USA.

In the USA, GDP growth accelerated in 2017, before easing in the first quarter of 2018. The persistently optimistic sentiment of companies and households currently speaks against a slowdown of growth. Although the Fed is expected to raise interest rates further in the second half of 2018, the fiscal policy stance is clearly expansionary. Not only will the tax reform reduce the overall fiscal burden, but public spending will be significantly reinforced at the same time. Total output is projected to expand by 2.5 percent in 2018 and by 2.0 percent in 2019.

The East-central European markets that are key for Austrian exports are currently enjoying a cyclical boom. Their exporting companies benefit from the upswing in the euro area and in Russia. In addition, high real income gains and rising employment enable private households to significantly raise their spending on consumer goods. GDP for this group of countries is expected to expand by 4.1 percent in 2018 and 3.0 percent in 2019. The clear upward revision of the GDP growth rate for 2018 from the projection of last March is partly explained by the highly favourable performance towards the end of 2017 and the extraordinarily strong growth in the first quarter of 2018.

The upswing in the euro area economy continued in 2017. In the first quarter of 2018, the growth momentum weakened in most countries, although it still comfortably exceeded the expansion of the potential output (see also the assessment by the European Commission). Early 2018 saw a decline notably of business confidence, and leading indicators suggest a growth slowdown for the rest of the year. Nevertheless, the forces of growth are still robust, as witnessed inter alia by the lively job creation. Annual GDP growth is projected to accelerate to 2.2 percent in 2018, before subsiding to 1.8 percent in 2019.

WIFO expects Austrian companies' major export markets to expand by 2.4 percent in 2018 and 2.0 percent in 2019.

Prices for internationally traded crude oil hit a low in early 2016 and have steadily picked up since, probably as a consequence of a significant rundown of stocks provoked, according to OPEC[1], by supply cuts and solid demand for oil. Against this background, WIFO has revised up its oil price assumption. Other raw material prices have also recovered since 2016. With the continued, albeit more moderate upward trend in global economic activity, commodity prices should go further up in 2018, before levelling off in 2019.

Table 2: International economy

	Percentage shares 2017		2014	2015	2016	2017	2018	2019
	Austria's exports of goods	World GDP[1]	GDP volume, percentage changes from previous year					
EU	69.8	16.5	+ 1.8	+ 2.3	+ 2.0	+ 2.5	+ 2.3	+ 1.9
UK	2.8	2.3	+ 3.1	+ 2.3	+ 1.9	+ 1.8	+ 1.4	+ 1.3
Euro area	52.2	11.6	+ 1.3	+ 2.1	+ 1.8	+ 2.4	+ 2.2	+ 1.8
Germany	30.1	3.3	+ 1.9	+ 1.7	+ 1.9	+ 2.2	+ 2.2	+ 1.8
Italy	6.4	1.8	+ 0.1	+ 1.0	+ 0.9	+ 1.5	+ 1.4	+ 1.4
France	5.0	2.2	+ 1.0	+ 1.1	+ 1.2	+ 2.2	+ 1.8	+ 1.7
CEEC 5[2]	14.3	1.6	+ 3.2	+ 4.0	+ 2.8	+ 4.4	+ 4.1	+ 3.0
Czech Republic	3.7	0.3	+ 2.7	+ 5.3	+ 2.6	+ 4.4	+ 3.2	+ 2.4
Hungary	3.4	0.2	+ 4.2	+ 3.4	+ 2.2	+ 4.0	+ 4.2	+ 2.5
Poland	3.1	0.9	+ 3.3	+ 3.8	+ 3.0	+ 4.6	+ 4.5	+ 3.4
USA	6.8	15.3	+ 2.6	+ 2.9	+ 1.5	+ 2.3	+ 2.5	+ 2.0
Switzerland	5.3	0.4	+ 2.4	+ 1.2	+ 1.4	+ 1.0	+ 2.0	+ 1.9
China	2.6	18.2	+ 7.3	+ 6.9	+ 6.7	+ 6.9	+ 6.4	+ 6.0
Total[3]								
PPP-weighted[4]		50	+ 4.0	+ 4.1	+ 3.5	+ 4.0	+ 3.8	+ 3.4
Export weighted[5]	84		+ 2.1	+ 2.4	+ 2.1	+ 2.5	+ 2.4	+ 2.0
Market growth[6]			+ 4.0	+ 3.7	+ 3.3	+ 6.6	+ 5.8	+ 4.6
Forecast assumptions								
Crude oil prices								
Brent, $ per barrel			99.0	52.5	43.7	54.3	73	72
Exchange rate								
$ per €			1.329	1.110	1.107	1.129	1.23	1.23
Key interest rate								
ECB main refinancing rate[7], percent			0.2	0.1	0.0	0.0	0.0	0.1
10-year government bond yields Germany, percent			1.2	0.5	0.1	0.3	0.7	0.9

Source: WIFO. 2018 and 2019: forecast. – [1] PPP-weighted. – [2] Czech Republic, Hungary, Poland, Slovenia, Slovakia. – [3] EU, 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.

2.2 Economic policy stance turning less expansionary

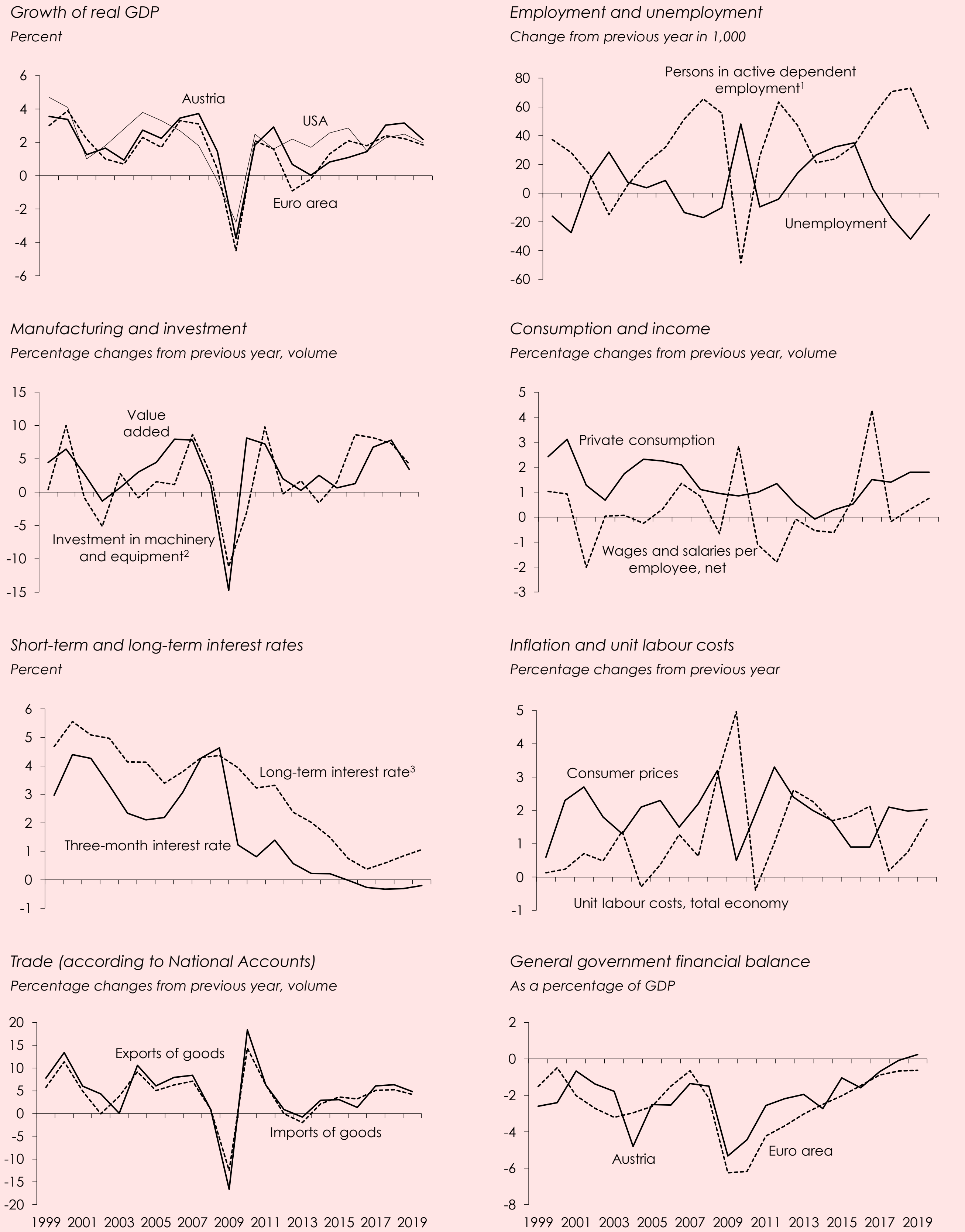
The assumptions on the policy environment underlying the present forecast include all macro-prudential monetary measures already adopted or sufficiently specified to consider their implementation likely. As for the domestic fiscal policy course, those measures from the government programme have been taken on board that have been passed by the Council of Ministers.

The ECB is likely to maintain its expansionary monetary policy stance in 2018. First moves towards higher interest rates should only be expected for 2019. Hence, financing conditions remain extremely favourable over the entire forecast period.

At present, the ECB's expansionary stance helps keeping interest rates on government bonds low. Given the rising capacity utilisation and gradually accelerating inflation in the euro area, monetary policy is likely to turn less accommodating, which explains the upward-bound market expectations for interest rates. In view of the termination of net bond purchases announced by the ECB for the end of 2018, WIFO now expects the first interest rate hikes for the end of 2019. Such a policy setting, with the Eurosystem no longer being a net buyer, should drive yields on euro area 10-year government bonds up, from currently 0.7 percent to 1.1 percent at the end of 2019. In parallel, interest rates for bank credits in Austria may tentatively head up and raise the cost of debt financing.

[1] OPEC Monthly Oil Market Report, 14 May 2018.

Figure 1: Indicators of economic performance



Source: WIFO. 2018 and 2019: 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).

Table 3: Fiscal and monetary policy – key figures

	2014	2015	2016	2017	2018	2019
	As a percentage of GDP					
Fiscal policy						
General government financial balance[1]	– 2.7	– 1.0	– 1.6	– 0.7	– 0.1	0.2
General government primary balance	– 0.3	1.3	0.5	1.1	1.5	1.7
General government total revenue	49.6	49.9	49.0	48.3	47.8	47.3
General government total expenditure	52.3	51.0	50.6	49.0	47.9	47.1
	Percent					
Monetary policy						
Three-month interest rate	0.2	– 0.0	– 0.3	– 0.3	– 0.3	– 0.2
Long-term interest rate[2]	1.5	0.7	0.4	0.6	0.8	1.1

Source: WIFO. 2018 and 2019: forecast. – [1] According to Maastricht definition. – [2] 10-year central government bonds (benchmark).

Macro-prudential policy in Austria does not see a need for curbing credit growth.

The credit-to-GDP gap in Austria stays broadly unchanged in negative territory[2]. Against this backdrop, the Austrian Financial Market Stability Board ("Finanzmarktstabilitätsgremium" FMSG) decided in March to further refrain from activating the counter-cyclical capital buffer and thus keep its level unchanged at 0 percent of risk-weighted assets. Still, a moderate tightening of macro-prudential policy over the forecast horizon seems likely, if only from the perspective of the implementation schedule of the Basle III regulations. However, given the persistently abundant liquidity supply by the ECB, credit growth in 2018 should remain largely unaffected. Despite the continued lively expansion of credit over the forecast period, the credit-to-GDP gap may, from today's perspective, still not have closed by the end of 2019.

Buoyant tax revenues from lively business activity improve the general government balance. The domestic fiscal policy stance keeps leaning towards expansion over the projection horizon.

On the assumptions underlying the present forecast, the government budget for 2018 remains in small deficit. For 2019, WIFO expects the general government balance (Maastricht definition) to swing to a surplus of 0.2 percent of nominal GDP. The budget balance continues to benefit from benign cyclical conditions and low debt service cost. Discretionary measures such as cuts or suspension for certain expenditure programmes also contribute to the improvement of the budget balance. A partial offset derives from certain revenue-dampening measures, inter alia the abolition of recourse claims for social nursing care expenditure or the reduction of the unemployment insurance contribution rate. An important new fiscal measure not yet incorporated into the previous forecast is the "family bonus". To be introduced in 2019, its full fiscal impact will be deferred to 2020, as beneficiaries will claim it mainly via wage tax refunds. The extent of such claims and thus the budgetary impact is difficult to anticipate; a similar uncertainty relates to the fiscal effect of the envisaged merger of social security funds.

3. Austria's economy in cyclical upswing despite mounting external uncertainties

The Austrian economy enjoys a cyclical boom, with growth being broadly sustained across demand components. On the output side, the manufacturing sector is the main growth driver. While the underlying cyclical path remains upward bound in Austria, the picture conveyed by leading indicators has recently become more clouded.

Latest results from the regular WIFO-Konjunkturtest (business cycle survey) show a distinct weakening of Austrian companies' assessments – for the first time since the beginning of the current upturn. For the overall economy, both the index for judgements on the present situation and that for forward-looking expectations have been on a downward slope since the beginning of the year, mainly due to the decline in cyclically crucial sectors like manufacturing. Despite a steady retreat from the peak recorded at the turn of the year, the UniCredit Bank Austria Purchasing Managers' Index signals continued expansion of industrial output, albeit at a significantly lower pace. The WIFO Leading Indicator shows a similar pattern, having dropped markedly four times in a row and on a broad range of components. In a similar vein, the Economic Barometer of the Austrian Economic Chambers shows companies' outlook being still upbeat, but down from the cyclical peak. Business expectations for the next twelve

[2] The credit-to-GDP gap is obtained as the difference between the current relation of outstanding credit to GDP and its trend. Following the BCBS method, a positive gap (i.e. the current credit or GDP relation is above trend) points to excessive credit growth (https://www.fmsg.at/en/publications/warnings-and-recommendations/2018/recommendation-fmsg-1-2018.html).

months have become less optimistic, especially those for order levels and domestic sales.

While corporate confidence has thus receded on a broad range in the first half of the year, it is still above its long-term average. After the peak reached at the turn of the year, this may be taken as a sign of "normalisation". Another reason are probably growing concerns about the extent of negative repercussions of rising protectionism, geo-political tensions and uncertain economic policies in several EU member countries. The overall impression conveyed by leading indicators is that the cyclical boom of the Austrian economy has passed its peak and that GDP growth is set to abate markedly over the forecast period.

Table 4: Gross value added

At basic prices

	2016	2017	2018	2019	2016	2017	2018	2019
	Billion € (reference year 2010)				Percentage changes from previous year			
Volume (chain-linked series)								
Agriculture, forestry and fishing	4.05	4.19	4.19	4.19	+ 2.7	+ 3.3	± 0.0	± 0.0
Manufacturing including mining and quarrying	57.14	61.01	65.77	68.00	+ 1.3	+ 6.8	+ 7.8	+ 3.4
Electricity, gas and water supply, waste management	8.35	9.22	9.68	9.87	+ 1.2	+10.4	+ 5.0	+ 2.0
Construction	16.23	16.64	16.94	17.18	+ 0.6	+ 2.5	+ 1.8	+ 1.4
Wholesale and retail trade	36.61	37.51	38.60	39.68	+ 1.4	+ 2.5	+ 2.9	+ 2.8
Transportation	15.21	15.63	16.03	16.35	+ 0.2	+ 2.8	+ 2.6	+ 2.0
Accommodation and food service activities	13.66	13.88	14.22	14.57	+ 2.5	+ 1.6	+ 2.5	+ 2.4
Information and communication	9.61	9.91	10.26	10.46	+ 1.2	+ 3.1	+ 3.5	+ 2.0
Financial and insurance activities	12.23	12.52	12.86	13.13	+ 0.3	+ 2.3	+ 2.7	+ 2.1
Real estate activities	26.13	26.44	26.84	27.37	+ 1.6	+ 1.2	+ 1.5	+ 2.0
Other business activities[1]	26.99	27.98	29.10	29.97	+ 1.9	+ 3.7	+ 4.0	+ 3.0
Public administration[2]	48.90	49.63	50.23	50.73	+ 1.7	+ 1.5	+ 1.2	+ 1.0
Other service activities[3]	7.78	7.84	7.92	8.00	– 0.7	+ 0.7	+ 1.0	+ 1.0
Total gross value added[4]	282.78	291.99	301.84	308.59	+ 1.3	+ 3.3	+ 3.4	+ 2.2
Gross domestic product at market prices	317.15	326.78	337.12	344.43	+ 1.5	+ 3.0	+ 3.2	+ 2.2

Source: WIFO. 2018 and 2019: 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 activities; activities of households (NACE R to U). – [4] Before deduction of subsidies and attribution of taxes on products.

3.1 Growth dynamics returning to normal

GDP growth accelerated markedly in Austria in 2017. With the currently less upbeat picture of leading indicators, demand and output are set to move to a slower pace over the forecast horizon, despite a favourable policy framework. From the current perspective, the business cycle has passed its upper turning point.

Under the present external conditions and policy settings, the adjusted annual rate of real GDP growth should edge up from 3.1 percent in 2017 to 3.2 percent in 2018, before moderating to 2.1 percent in 2019. The high rate for 2018 is mainly due to the sizeable carry-over of 1.4 percentage points from 2017. Growth during the calendar year, as measured by the fourth quarter year-on-year rate, is at 2.6 percent distinctly lower than the 3.6 percent for 2017, thereby reflecting the slower momentum as from the second half of the year (Figure 2). The momentum is still strong in the first semester, broadly at a par with the average of quarterly growth rates for the previous year. The GDP projection for 2019 is shaped by the rather moderate growth dynamics in the course of the year and a limited overhang. The unadjusted annual GDP growth rate for 2019 of 2.2 percent is biased upwards by the higher number of working days (Table 5).

Growth of the Austrian economy thereby distinctly exceeds the path of trend output. Overall capacity utilisation should remain high up to the projection horizon, with the output gap widening in positive territory. On present perspectives, the economy will therefore remain in a period of above-average capacity utilisation.

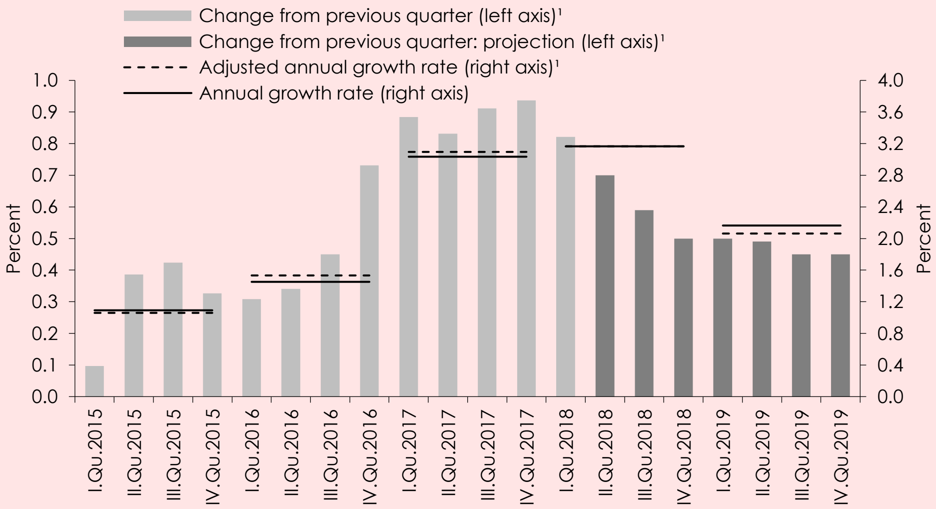
Table 5: Technical breakdown of the real GDP growth forecast

		2016	2017	2018	2019
Growth carry-over[1]	percentage points	+ 0.6	+ 0.9	+ 1.4	+ 0.8
Growth rate during the year[2]	percent	+ 1.8	+ 3.6	+ 2.6	+ 1.9
Annual growth rate	*percent*	*+ 1.5*	*+ 3.0*	*+ 3.2*	*+ 2.2*
Adjusted annual growth rate[3]	percent	+ 1.5	+ 3.1	+ 3.2	+ 2.1
Calendar effect[4]	percentage points	+ 0.2	– 0.3	± 0.0	+ 0.1

Source: WIFO. 2018 and 2019: 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. – [4] Impact of the annual number of working days and the leap day.

Figure 2: Cyclical profile Austria

GDP volume



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

Table 6: Private consumption, income and prices

	2014	2015	2016	2017	2018	2019
	Percentage changes from previous year, volume					
Private consumption expenditure[1]	+ 0.3	+ 0.5	+ 1.5	+ 1.4	+ 1.8	+ 1.8
Durable goods	– 1.0	+ 2.8	+ 3.3	+ 0.8	+ 2.0	+ 1.5
Non-durable goods and services	+ 0.4	+ 0.3	+ 1.3	+ 1.5	+ 1.8	+ 1.8
Household disposable income	+ 0.2	+ 0.4	+ 2.7	– 0.3	+ 1.9	+ 1.8
	As a percentage of disposable income					
Household saving ratio						
Including adjustment for the change in pension entitlements	6.8	6.9	7.9	6.4	6.5	6.5
Excluding adjustment for the change in pension entitlements	6.2	6.2	7.3	5.7	5.8	5.8
	Percentage changes from previous year					
Direct lending to domestic non-banks (end of period)	+ 0.3	+ 2.0	+ 1.8	+ 0.9	+ 2.4	+ 2.5
	Percent					
Inflation rate						
National	1.7	0.9	0.9	2.1	2.0	2.0
Harmonised	1.5	0.8	1.0	2.2	2.1	2.1
Core inflation[2]	1.9	1.7	1.5	2.2	2.0	2.1

Source: WIFO. 2018 and 2019: forecast. – [1] Private households including non-profit institutions serving households. – [2] Excluding energy and unprocessed food (meat, fish, fruits, vegetables).

On the demand side, the cyclical upswing is supported by lively domestic private investment and a robust increase in private consumption. The high degree of productive capacity utilisation encourages firms to invest in new machinery and business equipment. With the cyclical slowdown in the second half of the year, investment will gradually slacken. On annual average, machinery and equipment investment is expected to increase by 7.3 percent in 2018 and by 4.2 percent in 2019. Construction investment will also provide a positive contribution to GDP growth, gaining 2.0 percent in 2018 and 1.4 percent in 2019.

Private consumption will strongly support GDP growth in 2018 as well as in 2019. Household disposable income will post a substantial gain after a setback in 2017 (due to losses from property income and a base effect in wage tax liabilities after the tax cuts of 2016). Positive stimulus to income and consumption will also emanate from the introduction of the "family bonus" as from 2019. The benign labour market situation will also act as a stabiliser for household spending since the implicit reduction of income uncertainty gives less reason for precautionary saving. The private household saving rate is projected to remain broadly stable over the forecast period.

3.2 Slackening export growth

The forecast rests on the assumption that the current international trade disputes will not alter the structure of worldwide trade flows. With the continued expansion of global trade and business activity up to the projection horizon, Austrian exports should enjoy further growth. Although judgements on manufacturing export orders expressed in the regular WIFO-Konjunkturtest (business cycle survey) show no further improvement, the balance of positive over negative assessments is above the long-term average. The prospect of sustained export growth is also confirmed by the export indicator of Oesterreichische Nationalbank (OeNB).

Table 7: Expenditure on GDP

Volume (chain-linked series)

	2016	2017	2018	2019	2016	2017	2018	2019
	Billion € (reference year 2010)				Percentage changes from previous year			
Final consumption expenditure	228.80	231.69	235.55	239.43	+ 1.7	+ 1.3	+ 1.7	+ 1.6
Households[1]	164.90	167.21	170.22	173.29	+ 1.5	+ 1.4	+ 1.8	+ 1.8
General government	63.92	64.50	65.34	66.15	+ 2.1	+ 0.9	+ 1.3	+ 1.2
Gross capital formation	75.99	81.52	86.82	89.61	+ 3.5	+ 7.3	+ 6.5	+ 3.2
Gross fixed capital formation	72.77	76.32	79.46	81.68	+ 3.7	+ 4.9	+ 4.1	+ 2.8
Machinery and equipment[2]	25.27	27.33	29.32	30.56	+ 8.6	+ 8.2	+ 7.3	+ 4.2
Construction	32.60	33.43	34.10	34.58	+ 1.1	+ 2.6	+ 2.0	+ 1.4
Other investment[3]	14.99	15.73	16.30	16.87	+ 2.0	+ 4.9	+ 3.6	+ 3.5
Domestic demand	306.31	315.46	324.28	331.00	+ 2.1	+ 3.0	+ 2.8	+ 2.1
Exports	177.45	187.47	197.47	205.40	+ 1.9	+ 5.6	+ 5.3	+ 4.0
Travel	13.48	13.79	13.98	14.13	+ 2.3	+ 2.4	+ 1.4	+ 1.1
Minus Imports	166.57	176.12	184.51	191.82	+ 3.1	+ 5.7	+ 4.8	+ 4.0
Travel	6.76	7.18	7.39	7.52	+ 3.1	+ 6.2	+ 3.0	+ 1.8
Gross domestic product	317.15	326.78	337.12	344.43	+ 1.5	+ 3.0	+ 3.2	+ 2.2
Value	353.30	369.69	387.81	403.96	+ 2.6	+ 4.6	+ 4.9	+ 4.2

Source: WIFO. 2018 and 2019: forecast. – [1] Including non-profit institutions serving households. – [2] Including weapon systems. – [3] Mainly intellectual property products (research and development, computer programmes, copyrights).

Austrian exporting companies benefit from the resilience of demand from other EU member countries and from the USA, and especially from the cyclical revival in East-central Europe. Volume exports of goods and services are expected to increase by 5.3 percent in 2018 (after +5.6 percent in 2017) and 4.0 percent in 2019. The forecast implies tentative gains in foreign market shares even in the face of broadly unchanged price competitiveness.

In 2017, import growth was driven by robust domestic demand, notably for business machinery and equipment, and by buoyant exports (due to their high import content). With the stabilisation of investment during 2018, domestically-fuelled import growth should moderate somewhat and fall behind the increase in exports. Hence, net exports will provide positive contributions to GDP growth, both in 2018 and 2019.

Table 8: Productivity

	2014	2015	2016	2017	2018	2019
	Percentage changes from previous year					
Total economy						
Real GDP	+ 0.8	+ 1.1	+ 1.5	+ 3.0	+ 3.2	+ 2.2
Hours worked[1]	+ 0.3	− 0.8	+ 1.9	+ 2.0	+ 1.7	+ 1.1
Productivity[2]	+ 0.5	+ 1.9	− 0.4	+ 1.1	+ 1.4	+ 1.1
Employment[3]	+ 1.0	+ 0.7	+ 1.5	+ 1.7	+ 1.6	+ 1.1
Manufacturing						
Production[4]	+ 2.5	+ 0.6	+ 1.3	+ 6.8	+ 7.8	+ 3.4
Hours worked[5]	− 0.2	− 0.2	+ 0.7	+ 2.6	+ 3.4	+ 0.2
Productivity[2]	+ 2.7	+ 0.8	+ 0.6	+ 4.0	+ 4.2	+ 3.2
Employees[6]	+ 0.1	+ 0.5	+ 0.8	+ 1.1	+ 2.0	+ 0.4

Source: WIFO. 2018 and 2019: 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).

3.3 Job creation stays lively

Labour supply is expected to keep growing strongly over the entire projection period, driven by several factors: the increase in labour force participation of older workers due to tighter conditions for access to retirement and the secular increase in female labour force participation add to domestic labour supply; at the same time, the inflow of foreign workers will continue, mainly from other EU member countries. Labour market access of persons granted asylum or subsidiary protection status remains a major factor of uncertainty for the growth of labour supply. WIFO expects the number of persons in active employment or seeking a job to climb by 1.1 percent in 2018 and 0.8 percent in 2019.

The cyclical upswing goes hand in hand with strong employment growth. This leads to a decline in unemployment that is, however, limited by the unabated expansion of labour supply.

Table 9: Labour market

	2014	2015	2016	2017	2018	2019
	Change from previous year in 1,000					
Demand for labour						
Persons in active employment[1]	+ 31.8	+ 42.5	+ 62.3	+ 76.4	+ 79.0	+ 49.0
Employees[1,2]	+ 23.8	+ 33.2	+ 53.7	+ 70.7	+ 73.0	+ 43.0
National employees	− 8.1	+ 6.3	+ 17.7	+ 23.8	+ 25.0	+ 13.0
Foreign employees	+ 32.0	+ 27.0	+ 36.0	+ 46.8	+ 48.0	+ 30.0
Self-employed[3]	+ 8.0	+ 9.3	+ 8.6	+ 5.7	+ 6.0	+ 6.0
Labour supply						
Population of working age 15 to 64 years	+ 33.1	+ 52.3	+ 65.8	+ 23.0	+ 16.2	+ 13.7
Labour force[4]	+ 64.0	+ 77.5	+ 65.3	+ 59.0	+ 47.0	+ 34.0
Labour surplus						
Unemployed[5]	+ 32.2	+ 35.0	+ 3.0	− 17.3	− 32.0	− 15.0
Unemployed persons in training	+ 1.8	− 10.2	+ 2.1	+ 4.9	− 1.0	− 6.0
	Percent					
Unemployment rate						
As a percentage of total labour force (Eurostat)[6]	5.6	5.7	6.0	5.5	5.1	5.0
As a percentage of total labour force[5]	7.4	8.1	8.1	7.6	6.8	6.4
As a percentage of dependent labour force[5]	8.4	9.1	9.1	8.5	7.6	7.2
	Percentage changes from previous year					
Labour force[4]	+ 1.5	+ 1.8	+ 1.5	+ 1.4	+ 1.1	+ 0.8
Persons in active dependent employment[1,2]	+ 0.7	+ 1.0	+ 1.6	+ 2.0	+ 2.0	+ 1.2
Unemployed[5]	+ 11.2	+ 11.0	+ 0.8	− 4.9	− 9.4	− 4.9
Persons (in 1,000)	319.4	354.3	357.3	340.0	308.0	293.0

Source: WIFO. 2018 and 2019: 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.

Lively business activity is mirrored by a substantial improvement of the Austrian labour market. Employment growth accelerated in 2017 and extended to all economic sectors. Manufacturing industry created more and more full-time jobs, and the number of dependent employees' work hours rose faster than the number of new jobs (+2.6 percent vs. +1.1 percent). Both features are typical for a cyclical boom period. In early 2018, the positive developments gained further momentum. Against this background, the forecast for the number of persons in active dependent employment is revised upwards, to +73,000 or +2.0 percent for 2018. The carry-over from 2017 alone is responsible for some 46,000 more jobs in 2018. With the cyclical slowdown, employment will expand at a more moderate 43,000 persons or 1.2 percent in 2019.

The unemployment rate (on national definitions) stood at 8.5 percent on annual average 2017 and eased to a seasonally-adjusted 8.0 percent in the first quarter of 2018. While vibrant job creation reduces overall unemployment, the effect is countered by the strong expansion of labour supply. The unemployment rate is anticipated to subside to an average 7.6 percent in 2018 and 7.2 percent in 2019.

3.4 Inflation remains moderate

After a rate of 2.1 percent in 2017, inflation as measured by the consumer price index will stay virtually stable at an annual 2.0 percent both in 2018 and 2019. Both external and internal drivers are at work: import prices of raw materials and of finished manufactures are on a rising trend; on the domestic front, the output gap will widen in the positive range over the entire forecast period and exert upward pressure on prices. By contrast, real hourly wages will once again lag behind productivity growth, such that wage cost should not add to the inflationary pace.

Inflationary dynamics is shaped by internal as well as external factors. Over the entire projection period, upward price pressure is likely to be higher than on average for the last years.

Table 10: Earnings, international competitiveness

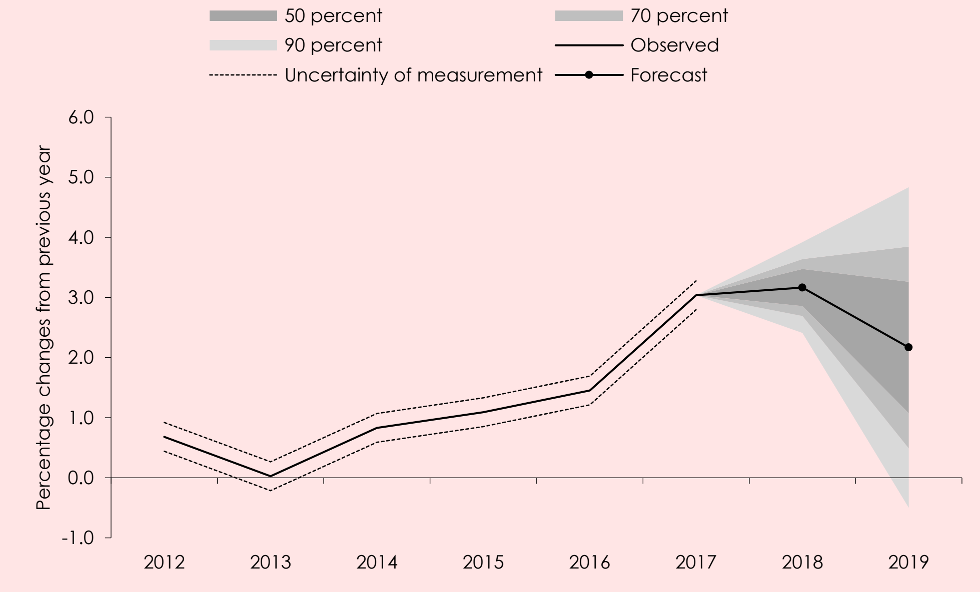
	2014	2015	2016	2017	2018	2019
	Percentage changes from previous year					
Wages and salaries per employee[1]						
Nominal, gross	+ 1.7	+ 2.1	+ 2.3	+ 2.0	+ 2.6	+ 2.7
Real[2]						
Gross	− 0.0	+ 1.2	+ 1.3	− 0.1	+ 0.6	+ 0.7
Net	− 0.6	+ 0.7	+ 4.3	− 0.2	+ 0.3	+ 0.8
Wages and salaries per hour worked[1]						
Real, net[2]	− 0.2	+ 2.4	+ 3.8	− 0.6	+ 0.0	+ 0.9
	Percent					
Wage share, adjusted[3]	68.6	69.0	69.0	67.6	66.8	66.5
	Percentage changes from previous year					
Unit labour costs, nominal[4]						
Total economy	+ 1.7	+ 1.8	+ 2.1	+ 0.2	+ 0.8	+ 1.7
Manufacturing	− 0.1	+ 1.5	+ 2.1	− 2.4	− 1.2	+ 0.3
Effective exchange rate – manufactured goods[5]						
Nominal	+ 1.2	− 2.9	+ 1.2	+ 0.7	+ 1.5	+ 0.1
Real	+ 1.5	− 2.9	+ 1.3	+ 1.0	+ 1.6	+ 0.1

Source: WIFO. 2018 and 2019: 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.

4. The risk environment

Next to the projection of the most likely evolution of economic aggregates (baseline projection), judgements on the qualitative and quantitative risks form a central element of economic forecasts. This relates not only to the external assumptions, but also to other elements of uncertainty surrounding the point estimates. For this reason, the point projections for GDP growth rates are supplemented by calculations of margins of uncertainty. The 70 percent forecast interval derived from past forecast errors ranges for 2018 from +2.7 percent to 3.6 percent and for 2019 from +0.5 percent to +3.8 percent (Figure 3).

Figure 3: Margins of uncertainty for the forecast of real GDP growth



Source: WIFO. Calculated on the basis of national accounts revisions and ex-post revealed forecast errors, respectively.

The projections presented here delineate the most likely scenario for economic growth from today's perspective and on the underlying assumptions. However, the actual outturn may deviate from this path for a multitude of reasons.

Since the end of 2017, uncertainties concerning the outlook for Austria's economy have significantly increased. Even the short-term growth outlook is difficult to assess, due to mixed signals from different cyclical indicators.

The forecast risks for the external sector are clearly downward bound. With the introduction of import tariffs for steel and aluminium by the USA and of retaliatory duties by the EU, the conflict over trade policy has taken on a hitherto unknown scope. The damages from a potential next escalation move – such as US tariffs on motor car imports – could rise to several billion euro in output losses and shave off a couple of tenths of a percentage point from Austria's GDP growth rate. In addition, the difficult economic and political situation in Italy and the implementation of the UK withdrawal from the EU may undermine business developments beyond the degree of uncertainty underlying this forecast. Rising geo-political tensions in the Middle East hold further global downward risks, not least for oil prices. A possible major upsurge, such as following supply cuts or disruptions, may however be countered by supply increases from other countries.

The domestic forecast risks, seen from today's perspective, would rather suggest that Austria's GDP growth may surprise on the upside. Indeed, the impact of the introduction of the "family bonus" has been cautiously factored into the forecast for 2019, since it is still uncertain to what extent the bonus will be taken up. Its impact on the labour market may turn out significantly stronger than anticipated. These upward risks to the employment forecast also hold the possibility of higher-than-expected growth of private consumption. If in such a scenario the additional stimulus would extend to private investment, the positive overall effect for the Austrian economy could be importantly stronger.