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## Strong Cyclical Upswing Losing Momentum

### Economic Outlook for 2011 and 2012

**The business cycle upturn in Austria is set to continue. Lively global demand is driving up exports, and also investment in machinery and equipment should post strong gains over the forecast period. Short-term indicators nevertheless point to some slackening during the remainder of the year. The expansion of the world economy loses steam under the impact of higher raw material and energy prices, a more restrictive stance of monetary policy in some emerging markets, and the continued burden on private households in the USA. The crisis in the euro area is adding to uncertainty on the part of companies and consumers. WIFO expects GDP to grow by around 3.0 percent in 2011, followed by +1.8 percent in 2012. External cyclical risks have increased over the last few months.**

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The recovery of the world economy continued in the first quarter 2011, as global trade and world industrial output grew rapidly. Once again, major cyclical stimulus came from the emerging markets in Asia, Latin America and East-central Europe. Meanwhile, the momentum of the rebound is gradually diminishing. In all regions, there are signs of a noticeable slowdown of growth in the further course of the year. Major reasons are the rise in commodity and energy prices as well as monetary tightening in several emerging market economies. Nevertheless, the world economy should retain substantial upward momentum over the forecast period. Particularly in Asia, Latin America and East-central Europe, growth is set to remain lively.

In the USA, total output will increase more slowly up to the forecast horizon than earlier projected. Reasons are the unexpectedly sluggish performance in the first quarter, the persistently high unemployment, the high debt burden weighing on private households, the further adverse trend on real estate markets, and a more restrictive stance of monetary and fiscal policy.

Growth in the euro area is moderate, with divergence persisting between one group of strongly expanding export-oriented economies, led by Germany, and the crisis-ridden countries in southern Europe and Ireland. The UK economy is expected to grow only slowly, while prospects for the Scandinavian countries and for East-central Europe are highly positive.

The international risks are on the rise. In particular the upward drift of commodity and energy prices, the consequences of the earthquake in Japan, the political manoeuvre in the USA about the increase in the public debt ceiling and the crisis in the euro area may further weaken the global business cycle upswing.

In Austria, the upswing continued into early 2011. Buoyant activity in Germany made for further strong gains in exports, and investment in machinery and equipment also kept heading up. However, in line with the international environment, the pace of growth is set to slow also in Austria, as already foreshadowed by latest results from the regular WIFO Business Cycle Survey. While demand and output should post a healthy gain of 3.0 percent in 2011, WIFO expects GDP growth to moderate to 1.8 percent in 2012.

Table 1: Main results

		2007	2008	2009	2010	2011	2012
		Percentage changes from previous year					
GDP							
Volume		+ 3.7	+ 2.2	- 3.9	+ 2.1	+ 3.0	+ 1.8
Value		+ 5.9	+ 4.1	- 3.1	+ 3.7	+ 5.3	+ 3.9
Manufacturing <sup>1</sup> , volume		+ 8.5	+ 3.5	- 14.0	+ 6.9	+ 8.5	+ 4.5
Wholesale and retail trade, volume		+ 2.0	+ 0.9	- 1.4	+ 2.9	+ 1.2	+ 1.1
Private consumption expenditure, volume		+ 0.7	+ 0.5	+ 1.3	+ 1.1	+ 0.9	+ 1.1
Gross fixed investment, volume		+ 3.9	+ 4.1	- 8.8	- 1.0	+ 3.8	+ 2.2
Machinery and equipment		+ 6.6	+ 7.5	- 14.5	+ 2.1	+ 8.0	+ 3.5
Construction		+ 1.6	+ 1.6	- 6.0	- 3.0	± 0.0	+ 1.0
Exports of goods <sup>2</sup>							
Volume		+ 9.0	+ 0.3	- 18.7	+ 12.8	+ 10.0	+ 7.6
Value		+ 10.5	+ 2.5	- 20.2	+ 16.5	+ 14.2	+ 8.7
Imports of goods <sup>2</sup>							
Volume		+ 7.6	+ 0.2	- 15.1	+ 11.1	+ 8.5	+ 6.9
Value		+ 9.6	+ 4.7	- 18.4	+ 16.3	+ 13.6	+ 8.3
Current balance	billion €	+ 9.62	+ 13.76	+ 8.53	+ 7.76	+ 9.57	+ 10.75
As a percentage of GDP		+ 3.5	+ 4.9	+ 3.1	+ 2.7	+ 3.2	+ 3.5
Long-term interest rate <sup>3</sup>	in percent	4.3	4.4	3.9	3.2	3.6	3.8
Consumer prices		+ 2.2	+ 3.2	+ 0.5	+ 1.9	+ 3.2	+ 2.6
Unemployment rate							
Eurostat definition <sup>4</sup>	in percent	4.4	3.8	4.8	4.4	4.2	4.2
National definition <sup>5</sup>	in percent	6.2	5.9	7.2	6.9	6.6	6.6
Persons in active dependent employment <sup>6</sup>		+ 2.1	+ 1.7	- 1.5	+ 0.8	+ 1.6	+ 0.9
General government financial balance according to Maastricht definition							
As a percentage of GDP		- 0.9	- 0.9	- 4.1	- 4.6	- 3.1	- 2.9

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

Lively business activity is giving rise to a marked increase in employment and a decline in unemployment in 2011 as compared with the previous year. Looking forward, however, job creation will lose momentum and no longer keep up with the growth of labour supply. Thus, 2012 will see no further inroads into unemployment, the jobless rate stabilising at 6.6 percent of the dependent labour force (national definition) or 4.2 percent of the total labour force (Eurostat definition).

Consumer prices will rise by a significant 3.2 percent in 2011, due to the jump in commodity and energy prices. 0.4 percentage point of the inflation rate is accounted for by higher indirect taxes decided as part of the fiscal consolidation programme. Both effects will abate in 2012, while the dynamics of wages and salaries may accelerate. Overall, the inflation rate is projected at 2.6 percent.

The general government balance will steadily improve over the forecast period. Buoyant tax revenues, driven by lively business activity, together with the consolidation measures taken will reduce the government deficit to 3.1 percent of GDP in 2011 and 2.9 percent in 2012.

The world-wide economic upswing continued in early 2011. According to the Netherlands' Centraal Planbureau (CPB), global trade grew by 2.6 percent quarter-on-quarter in the first three months of the year, exceeding the pace of the two earlier periods, and industrial output gained 2 percent. Growth was particularly lively in the emerging markets in Asia, Latin America and East-Central Europe, the major drivers of the world economy.

**Global economic upswing losing steam**

Meanwhile, global business activity is slackening somewhat. World trade showed first signs of weakening in April, not only in the industrialised countries, but particularly also in the emerging markets in Asia and Latin America. To some extent this has probably been caused by the production slump in Japan that mainly disrupted the intra-Asian supply chain. Besides, the measures taken in Asia and Latin America to avoid cyclical overheating may have produced early effects.

Table 2: World economy

	2007	2008	2009	2010	2011	2012
	Percentage changes from previous year					
<i>Real GDP</i>						
World	+ 5.4	+ 2.9	- 0.6	+ 4.9	+ 4.1	+ 4.2
USA	+ 1.9	± 0.0	- 2.6	+ 2.9	+ 2.4	+ 2.5
Japan	+ 2.4	- 1.2	- 6.3	+ 4.0	+ 0.5	+ 2.5
EU 27	+ 3.0	+ 0.5	- 4.3	+ 1.8	+ 2.0	+ 1.8
Euro area 17	+ 2.9	+ 0.4	- 4.1	+ 1.8	+ 1.8	+ 1.5
Germany	+ 2.7	+ 1.0	- 4.7	+ 3.6	+ 3.4	+ 1.8
New EU countries <sup>1</sup>	+ 5.9	+ 4.1	- 3.2	+ 2.2	+ 3.2	+ 3.5
China	+14.2	+ 9.6	+ 9.2	+10.3	+ 9.5	+ 8.5
World trade, volume	+ 7.0	+ 2.5	-12.8	+15.4	+ 8.5	+ 7.5
Market growth <sup>2</sup>	+ 7.5	+ 2.9	-11.5	+11.5	+ 9.5	+ 7.0
<i>Primary commodity prices</i>						
HWI index, total	+12.4	+31.7	-34.4	+29.0	+35	+ 1
Excluding energy	+17.8	+18.3	-28.0	+31.5	+25	+ 5
<i>Crude oil prices</i>						
Brent, \$ per barrel	72.5	97.0	61.5	79.5	110	110
<i>Exchange rate</i>						
\$ per euro	1.371	1.471	1.393	1.327	1.45	1.40

Source: WIFO Economic Outlook. – <sup>1</sup> Bulgaria, Czech Republic, Hungary, Latvia, Lithuania, Poland, Romania. – <sup>2</sup> Real import growth of trading partners weighted by Austrian export shares.

World-wide economic expansion is likely to continue, but at reduced speed. In China, GDP rose at an annual rate of 9.7 percent in the first quarter, hardly less than in the previous period, but higher food prices weigh on private consumption and add to inflation which in May climbed to an annual rate of 5.5 percent. Against this background, the Chinese Central Bank steadily increased interest rates and minimum reserve requirements in order to dampen credit growth. As a result, GDP growth is projected to gradually abate to annual rates of 9.5 percent in 2011 and 8.5 percent in 2012.

The Japanese economy continues to suffer from the repercussions of the earthquake and tsunami of March 2011. Early signs of a deceleration of growth were observed already before the natural disaster when GDP in the first quarter 2011 receded for the second time in a row. In March, industrial production slumped by 15 percent from the previous month under the impact of power cuts and disruptions in the supply chain. In April, first tentative signs of recovery were observed. While for the summer further setbacks due to electricity shortages are to be expected, the incipient reconstruction should generate a marked expansionary impact in the second half of the year.

The US economy grew by 0.5 percent in the first quarter, after +0.8 percent in the last three months of 2010. Demand for durable consumer goods, investment in machinery and equipment, inventory build-up and exports all provided major support, although imports rose equally strongly. Indicators of output and orders point to continued expansion, although the momentum will slow down markedly. Consumer confidence remains fragile with unemployment becoming increasingly sticky, private indebtedness being high and excess supply prevailing on real estate markets, leading to a renewed fall in house prices of late. In the months to come, fiscal policy will also turn more and more restrictive. The Federal Reserve has announced to launch no further programme for the purchase of loans and bonds (quantitative easing), but it will keep its balance sheet total constant and thus retain some scope for bond pur-

*The world economy continues to expand at a healthy pace, driven by robust activity in the emerging markets in Asia and Latin America. Looking ahead, however, growth is likely to decelerate. Monetary restraint to counter overheating in the emerging markets, subdued private household confidence in the USA and the euro area crisis are the major factors weighing on global demand and output growth.*

chases. For 2011 and 2012, GDP growth is expected at 2.4 percent and 2.5 percent, respectively.

The cyclical profile in the EU remains uneven. In Germany and several countries enjoying close trade relations with the German economy (France, Netherlands, Austria, Czech Republic, Slovakia), in East-central Europe and Scandinavia, GDP remained strongly upward bound in the first quarter 2011, while remaining flat in Italy and Spain and receding in Portugal. In Greece, GDP headed up in the first quarter against the previous period, but was still 5 percent below the year-earlier level. Also in Ireland, demand and output picked up in the first three months of this year, but were hardly higher than one year ago. In the UK, GDP stagnated during the last six months. These developments hold back growth in the euro area and in the EU at large. Euro area GDP in the first quarter rose by 0.8 percent from the previous period, after a gain of 0.3 percent in the fourth quarter 2010.

Given the slow momentum of the recovery, the labour market has hardly improved so far. The jobless rate in the euro area of nearly 10 percent in April was close to its peak during the financial market and economic crisis. Particularly in Greece, Ireland, Portugal and Spain as well as in the Baltic countries, unemployment is dramatically high and stagnating or rising further, thereby weighing on consumer confidence and private household spending.

Prospects for the euro area and for the entire EU remain unequal. In Germany, industrial output developed favourably in the first quarter, while no upward trend can be observed in France, the UK, Ireland, Italy, Portugal and Spain. Consumer sentiment is flat nearly everywhere. Overall, cyclical indicators signal a slowdown also for the euro area. For the entire year 2011, WIFO expects GDP to grow by 1.8 percent, followed by 1.5 percent in 2012. The pace of activity should weaken also in Germany. The slower expansion of the world economy will be felt most in the export sector, the driver of growth so far. Nevertheless, the German economy will continue to benefit from buoyant activity in the emerging markets. GDP is projected to increase by 3.4 percent in 2011 and by 1.8 percent in 2012.

In Scandinavia and the new member countries in East-central Europe, growth should stay lively over the forecast period. In the UK, however, the planned savings in government spending are likely to weaken private sector expectations. Overall, GDP growth for the entire EU will in both years slightly exceed that of the euro area.

The risks surrounding the world-wide economic upswing are considerable and have become even greater in the last few months:

- Prices for raw materials and energy have recently levelled off, but remain high after a jump in the first half of the year. This trend has been reflected already in a world-wide acceleration of consumer price inflation, weighing on private household demand. Underlying the present forecast is the assumption of broadly stable commodity prices. Should they, however, continue their upward drift, private consumption growth is likely to slacken notably in the emerging markets. Moreover, central banks in many countries may feel obliged to raise interest rates which would significantly slow the pace of the global cyclical upswing.
- In the USA, political manoeuvres about the increase in the current ceiling for public debt continue and may culminate in summer 2011 in an insolvency of the federal government household. Scope and modalities of fiscal consolidation are still unknown. Rating agencies have threatened to downgrade US government bonds. In the event, this could destabilise US financial markets which are still burdened by high private household debt and adverse developments in the real estate sector, with potential negative repercussions and shocks for the global financial system.
- Japan may suffer further cuts in electricity during summer 2011. This may give rise to renewed shortfalls in output and disruptions in supply relations, thereby adversely affecting international trade.

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### **Retarding factors affecting the euro area recovery**

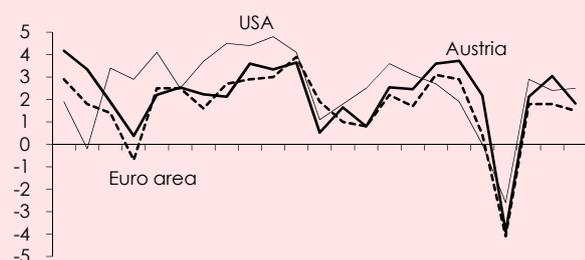
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### **International risks on the rise**

Figure 1: Indicators of economic performance

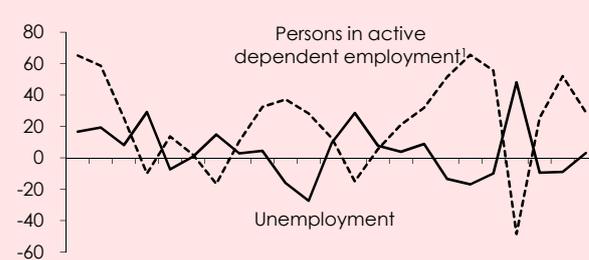
## Growth of real GDP

Percent



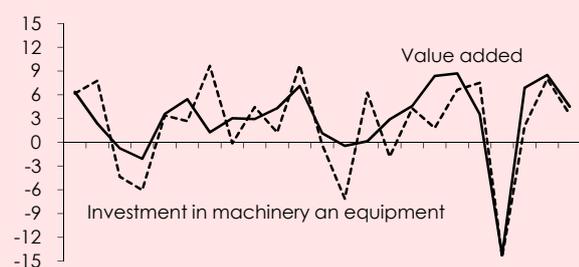
## Employment and unemployment

1,000 from previous year



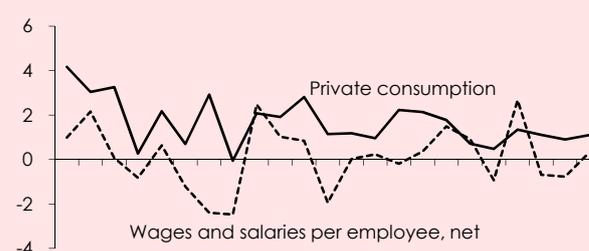
## Manufacturing and investment

Percentage changes from previous year, volume



## Consumption and income

Percentage changes from previous year, volume



## Short-term and long-term interest rates

Percent



## Inflation and unit labour costs

Percentage changes from previous year



## Trade

Percentage changes from previous year, volume



## General government financial balance

As a percentage of GDP



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

- In the euro area, the crisis in Greece is adding to uncertainty. The EU member countries have tied the disbursement of further credit tranches and the granting of a second rescue package to the implementation of further consolidation measures. In the Greek parliament and the population, there is mounting resistance against additional saving constraints. A government default could drag other economies into crisis and destabilise the financial system in the euro area.

Growing uncertainty may lead to a fall in private consumption and investment, bringing the cyclical upswing to a halt.

- There is also the danger of rating agencies downgrading the creditworthiness of further countries in the euro area. In the countries concerned, this would necessitate further fiscal consolidation measures, dragging down private demand and possibly leading to a new recession and eventually to a situation similar to the one in Greece. Financial support to larger countries like Spain or Italy may come to exceed the fiscal and political capacity of the other EU member countries and jeopardise the cohesion of Monetary Union.
- The forecast assumes that the European Central Bank will raise its key intervention rate up to 2.5 percent by mid-2012. This may weigh on business activity notably in the crisis-ridden countries in southern Europe. Slackening commodity and energy prices as well as persistent weakness on labour markets could lead to lower inflation, implying a marked increase in real interest rates, putting strain on highly indebted private households and dampening firms' appetite for investment.

The Austrian economy expanded strongly in the past 12 months. In the first quarter 2011, GDP rose by 0.9 percent from the previous period (fourth quarter 2010 +1.0 percent). Growth was driven by exports and investment in machinery and equipment. Thus, firms are active in adding to their capital stock, laying the base for a self-sustained cyclical upswing. So far, the manufacturing sector has been the major beneficiary of strong demand.

Also for Austria, short-term cyclical indicators from April to June have pointed to a slowdown of growth ahead. In step with the international environment, export growth is set to decelerate. Firms' somewhat more cautious business outlook will dampen the appetite for investment. Over the forecast period, growth will be driven by exports and equipment investment, while private consumption keeps rising at a more moderate pace. The unexpected acceleration of inflation dampens real income gains, allowing only moderate increases in trade sector turnover. Construction activity is expected to pick up somewhat, whereas prospects for tourism are subdued. While growth will lose momentum going forward, annual GDP growth for 2011 will be strong, at 3.0 percent, before abating to 1.8 percent in 2012.

Lively economic activity in 2011 will generate sizeable employment gains and allow the jobless rate to decline. With the slowdown of GDP growth expected for 2012, the labour market is unlikely to improve further; the weaker momentum of job creation will stabilise the unemployment rate at a level markedly above the one registered before the crisis.

With the sizeable increase in tax revenues, the general government balance will improve significantly. By 2012, the deficit should fall below the Maastricht reference value of 3 percent of GDP. Higher commodity and energy prices will drive up inflation further. Consumer prices are projected to rise on average by 3.2 percent in 2011, followed by a more moderate increase of 2.6 percent in 2012.

The strong momentum of Austria's foreign trade is set to continue. In the first quarter, volume merchandise exports rose by 2.5 percent quarter-on-quarter, accelerating from the 1.8 percent gain registered for the previous three months' period.

In 2010, Austrian exporters benefited mainly from the boom in Asian emerging markets, partly through higher direct deliveries, but even more indirectly via supplies to the world-market-oriented German economy. Also the Black Sea area provided substantial growth contributions, driven by exports to Turkey. Exports to the new EU member countries and to other countries in East-central Europe were comparatively less dynamic. However, as from the third quarter of 2010, demand from this area for Austrian exports rebounded.

Likewise, Austrian imports increased strongly in the fourth quarter 2010 and the first quarter 2011 (by around 1¼ percent quarter-on-quarter each, in volume). While so

### Austria's economy pulled by global cyclical upswing

*The Austrian economy enjoys vigorous growth on the back of the global business cycle upturn. Yet, leading indicators signal a slowdown in the further course of the year. GDP is projected to gain 3.0 percent in 2011 and 1.8 percent in 2012.*

### Exports remain key growth driver

*The strong expansion of the world economy provides important incentives for Austria's exports. In particular exports to Germany and to East-central Europe will continue their upward trend over the forecast period.*

far no acceleration has been observed, the latter is likely to occur in the second half of the year on the back of lively demand for investment goods.

Latest results from the regular WIFO Business Cycle Survey suggest that the upward trend in Austria's foreign trade will flatten somewhat. While firms are still satisfied with their stock of foreign orders, leading indicators (expectations on the flow of new orders from abroad) edged down in May to match the survey results of autumn 2010. Owing to lively economic growth, notably in East-central Europe, exports will nevertheless stay dynamic. For the whole of 2011, goods exports are expected to gain 10 percent in volume, followed by +7.6 percent in 2012. The benign business conditions and in particular the strong pick-up in investment also lead to a substantial increase in imports. The current account surplus is nevertheless projected to widen further, from 3.2 percent of GDP in 2011 to 3.5 percent in 2012.

The manufacturing sector continues to benefit importantly from the business cycle upswing. In the first quarter 2011, value added rose by 1.9 percent quarter-on-quarter, after +2 percent in the last three months of 2010. Thus, the slump in output during the crisis has nearly been made up by now. Also, capacity utilisation in manufacturing industry is nearly back to its pre-crisis level.

The results of the regular WIFO Business Cycle Survey from last May nevertheless suggest a slowdown of growth. Firms' output expectations and their anticipation of business conditions softened between April and June, although maintaining their levels of end-2010. Judgements on the stock of orders weakened somewhat in May, signalling slower manufacturing output growth over the forecast period. The sector is highly export-dependent and therefore directly affected by the global cyclical slowdown. In 2011, value added will still gain a hefty 8.5 percent, due to the rapid expansion over the last 12 months, before narrowing to +4.5 percent in 2012.

Benign developments in the industrial sector have spurred corporate investment. For the last four quarters, expenditure on new machinery and business equipment has increased strongly. Only in the first quarter 2011, growth abated to 2.4 percent quarter-on-quarter. The level of equipment investment was still 5 percent lower than before the crisis. Given the still favourable order situation, the high capacity utilisation and strong corporate earnings, WIFO expects for 2011 a sizeable increase in machinery and equipment investment by 8 percent. However, as the WIFO Investment Survey indicates, the transition from and export-led to an investment-driven cycle has not yet been confirmed. The deceleration of business activity in 2012 is likely to dampen firms' readiness to further add to their capital stock. WIFO expects an increase of 3.5 percent for the latter year.

### Upswing in manufacturing encourages investment

*The manufacturing sector benefits importantly from the swift rise in exports. As a consequence, companies step up their investment, although they may turn more cautious with the upswing shifting into lower gear.*

Table 3: Productivity

	2007	2008	2009	2010	2011	2012
	Percentage changes from previous year					
<i>Total economy</i>						
Real GDP	+ 3.7	+ 2.2	- 3.9	+ 2.1	+ 3.0	+ 1.8
Employment <sup>1</sup>	+ 1.7	+ 2.2	- 0.8	+ 1.0	+ 1.5	+ 0.8
Productivity (GDP per employment)	+ 2.0	- 0.0	- 3.1	+ 1.1	+ 1.5	+ 1.1
<i>Manufacturing</i>						
Production <sup>2</sup>	+ 8.7	+ 3.5	-14.3	+ 6.9	+ 8.5	+ 4.5
Employees <sup>3</sup>	+ 2.6	+ 1.7	- 5.3	- 1.3	+ 1.2	- 0.9
Productivity per hour	+ 6.3	+ 2.3	- 6.1	+ 5.0	+ 6.2	+ 5.4
Working hours per day per employee <sup>4</sup>	- 0.3	- 0.5	- 3.6	+ 3.1	+ 1.0	± 0.0

Source: WIFO Economic Outlook. – <sup>1</sup> Dependent and self-employed according to National Accounts definition. – <sup>2</sup> Value added, volume. – <sup>3</sup> According to Federation of Austrian Social Security Institutions. – <sup>4</sup> According to "Konjunkturerhebung" of Statistics Austria.

After a severe slump in 2010, construction activity is unlikely to pick up overall in 2011. In the first quarter, output continued to fall, especially in civil engineering and in residential construction. Non-residential building activity, however, has started to recover.

### Construction activity hardly recovering

Activity in civil engineering suffers from cuts in federal government investment plans and the postponement of projects, notably in 2012. Demand from lower government levels is also sluggish. Unlike in civil engineering, the building sector enjoys a steady rise in new orders. A slight increase in residential building permits issued in 2011 will be reflected in output growth. The results from the WIFO Business Cycle Survey confirm the relatively better outlook for the building sector. The government programme for the promotion of energy-saving investment in residential as well as commercial buildings should more than offset cuts applied to the conventional homebuilding subsidies. Thus, developments in 2012 will be markedly uneven: output growth in the building sector, but a decline in civil engineering. Overall, WIFO expects construction value added to edge up by 1 percent.

Expenditure by private households only edged up by 0.2 percent quarter-on-quarter in the first quarter 2011, like in the four periods before. All along the economic crisis, private consumption had proved resilient, such that it is now markedly above its cyclical peak of 2008. Nevertheless, consumption has so far given little momentum to the upswing. The slow trend is likely to persist up to the forecast horizon, with growth hovering around 1 percent both in 2011 and 2012. Demand for durable consumer goods remains sluggish, mainly due to echo effects after the massive pre-emptive purchases of motor cars in 2009, before the expiry of the government car-scrapping premium. Demand for durable consumer goods is expected to recover only by 2012.

The modest gains in real disposable income are of major influence on private consumption. Wage settlements in autumn 2010 were moderate, given the low consumer price inflation at the time. In 2011, gross wages per capita are likely to rise by 2.7 percent, whereas real wages will be squeezed by the unexpected hike of inflation. The wage round of spring 2011 partly accommodated for the acceleration in inflation. Wage settlements in autumn 2011 will yield markedly higher increases, given the benign business and labour market conditions as well as the jump in consumer prices. The WIFO projection is for a gain in gross wages per capita by 3.2 percent, implying a return to positive real income growth.

Construction activity is set to remain sluggish up to the forecast horizon. Prospects are particularly negative for civil engineering. The building sector may benefit from rising demand for commercially used structures.

## Growth of income and consumption staying moderate

Private consumption is set to maintain a moderate upward trend over the entire forecast period, on account of only sluggish income growth.

Table 4: Private consumption, income and prices

	2007	2008	2009	2010	2011	2012
	Percentage changes from previous year					
Private consumption expenditure	+ 0.7	+ 0.5	+ 1.3	+ 1.1	+ 0.9	+ 1.1
Durables	+ 2.6	+ 1.7	+ 5.2	- 1.0	+ 0.6	+ 1.1
Non-durables and services	+ 0.5	+ 0.3	+ 1.0	+ 1.3	+ 0.9	+ 1.1
Household disposable income	+ 2.3	+ 0.9	- 0.0	- 0.9	+ 0.7	+ 1.2
	As a percentage of disposable income					
Household saving ratio <sup>1</sup>	11.6	11.8	11.1	9.1	9.0	9.1
Household saving ratio <sup>2</sup>	11.2	11.6	10.4	8.7	8.5	8.6
	Percentage changes from previous year					
Direct lending to domestic non-banks <sup>3</sup>	+ 3.6	+ 7.4	- 1.3	+ 2.9	+ 4.5	+ 4.0
	Percentage changes from previous year					
Inflation rate						
National	2.2	3.2	0.5	1.9	3.2	2.6
Harmonised	2.2	3.2	0.4	1.7	3.4	2.7
Core inflation <sup>4</sup>	1.9	2.4	1.5	1.2	2.5	2.5

Source: WIFO Economic Outlook. – <sup>1</sup> Including adjustment for the change in net equity of households in pension fund reserves. – <sup>2</sup> Excluding adjustment for the change in net equity of households in pension fund reserves. – <sup>3</sup> End of period. – <sup>4</sup> Excluding unprocessed food (meat, fish, fruits, vegetables) and energy items.



should fall by 9,000 in 2011 from the previous year, keeping the annual average by 30,000 persons above the level recorded in 2008. In 2012, the jobless figure is likely to head up slightly, leaving the unemployment rate at 6.6 percent of the dependent labour force or 4.2 percent of the total labour force (Eurostat definition).

The restraint in public expenditure for active labour market policy, the shift in the population structure towards age-groups of high labour force participation rates (45 to 55 year olds), rising workforce participation among higher age groups, the introduction of an income maintenance threshold and the attractiveness of the Austrian job market for workers from other EU member countries are all mirrored by a marked increase in labour supply. The impact of the opening of the domestic labour market for workers from the new EU member countries is still uncertain. First results for May are in line with earlier WIFO projections.

The strong output gains in manufacturing will entail not only an increase in the number of jobs in 2011, but also in hours worked per capita. With the cyclical slowdown in 2012, job losses are likely to recur in manufacturing.

Raw material and energy prices have drifted up quickly in the last few months. The price of Brent which at the beginning of the year had been at \$ 95 per barrel, rose to a peak of \$ 125 in April, before easing to around \$ 110 by the end of June. World market quotations for agricultural and industrial commodities also rose markedly before levelling off in May 2011.

These hikes in commodity prices are feeding through to consumer prices. In May, the Harmonised Index of Consumer Prices (HICP) according to Eurostat rose to 3.7 percent in Austria (3.2 percent according to the national Consumer Price Index CPI). Some 40 percent of the increase was due to higher energy and food prices. Since early 2011, the HICP for Austria increasingly deviates from the euro area average, with the gap reaching 1 percentage point in May. The difference is even more marked for the rate of core inflation (excluding energy and unprocessed food) which in May was 1.3 percentage points higher in Austria than the euro area average. This divergence can be observed across all commodity groups<sup>1</sup> except private household energy consumption. The inflation differential vis-à-vis the euro area average is most significant for services, notably for travel and hotel services.

In the context of the programme for the consolidation of public finances, several indirect taxes have been raised (mineral oil and tobacco tax as from 1 January 2011, car registration tax as from 1 March 2011) or newly introduced (air ticket charge as from 1 April 2011). According to WIFO calculations, these tax increases push up the annual headline inflation for 2011 by around 0.4 percentage point.

The present forecast assumes that commodity and energy prices will stabilise going forward. On this assumption, consumer prices (according to CPI) will rise by an average 3.2 percent in 2011 (according to HICP +3.4 percent). In 2012, the impact of the indirect tax hikes on the inflation rate will quickly fade out. Likewise, the drift in raw material and energy prices should abate. However, wages and salaries are likely to show somewhat stronger upward momentum. WIFO expects headline inflation at an average 2.6 percent.

Thanks to the benign cyclical conditions, government revenues will increase faster over the forecast period than assumed so far. Receipts from profit taxes as well as from wage tax and from VAT post strong gains. Moreover, the revenue-related consolidation measures show early effects (in particular the higher mineral oil tax and the introduction of a bank levy) and facilitate the improvement of the budget balance. The general government deficit for 2011 is projected at 3.1 percent of GDP and for 2012 at 2.9 percent of GDP, provided that the Länder and the municipalities keep to their deficit targets defined in the revived domestic stability pact.

### Commodity and energy prices driving inflation

*Higher prices for raw materials and energy, together with higher indirect taxes in the context of fiscal consolidation will significantly push up headline inflation. In 2012, the upward drift of consumer prices is likely to abate.*

### Higher revenues take down the government deficit

<sup>1</sup> According to the definition of Eurostat-COICOP-1-digits and the special aggregates for the HICP.

## Methodological Notes and Short Glossary

### Period comparisons

Time-series comparisons with the previous period, e.g., the previous quarter, are adjusted for seasonal effects. They also include effects that result from a different number of working days in the period (e.g., Easter). In the text, reference is made to "seasonally and working day adjusted changes".

The phrase "changed compared with a year before . . .", on the other hand, describes a change compared with the same period a year before and refers to unadjusted time series.

The analysis of the seasonally and working day adjusted development provides more precise information about the actual course of economic activity and shows turning points sooner. However, the data are subject to additional revisions as seasonal adjustment is based on statistical methods.

### Real and nominal values

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

### Production Sector

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

### Inflation, CPI und HICP

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

Core inflation as a monetary policy indicator is not clearly defined. WIFO follows the common practice of using the inflation rate excluding the product categories unprocessed food and energy for core inflation. Thus just under 87 percent of the goods and services contained in the consumer price index (CPI 2010) are included in the calculation of core inflation.

### WIFO Business Cycle Survey and WIFO Investment Survey

The WIFO Business Cycle Survey is a monthly survey in which around 1,100 Austrian firms are asked to assess their current and future economic situation. The WIFO investment survey is conducted twice a year, asking companies about their investment activity (<http://www.itkt.at/>). The indicators are balances between the positive and negative responses expressed as a percentage of the total number of firms sampled.

### Unemployment rate

Austrian national definition: The number of persons registered as job seekers with the Public Employment Service expressed as a percentage of the dependent labour force. Labour force is the sum of the unemployed and the persons in dependent employment (measured in standard employment relationships). Database: registrations with the Public Employment Service (AMS) and Association of Austrian social insurance agencies.

Definition according to ILO and EUROSTAT: Any person who is not gainfully employed and is actively seeking work is considered unemployed. Gainfully employed persons comprise all persons who during the reference week worked for at least one hour in a self-employed capacity or in paid employment. Persons receiving child-care benefit and apprentices are classified as gainfully employed, whereas persons in military service or persons carrying out alternative service are not. The unemployment rate is the number of unemployed persons expressed as a percentage of the total labour force (unemployed persons plus gainfully employed persons). Database: data from household surveys ("Mikrozensus").

### Terms used in connection with the national definition of the unemployment rate

Persons in training: Persons who at a set date are enrolled in AMS (Public Employment Service) training programmes. When calculating the unemployment rate, their number is not taken into account either in the denominator or in the numerator.

Persons in dependent active employment: "Persons in dependent employment" include persons receiving child-care benefit, as well as persons in military service or persons carrying out alternative service with a valid employment contract. By deducting their number one arrives at the number of "persons in dependent active employment".

Table 7: Key policy indicators

	2007	2008	2009	2010	2011	2012
	As a percentage of GDP					
<i>Fiscal policy</i>						
General government financial balance						
According to Maastricht definition	- 0.9	- 0.9	- 4.1	- 4.6	- 3.1	- 2.9
According to National Accounts	- 1.0	- 1.0	- 4.1	- 4.6	- 3.1	- 2.9
General government primary balance	+ 1.9	+ 1.7	- 1.3	- 2.0	- 0.6	- 0.3
	In percent					
<i>Monetary policy</i>						
3-month interest rate	4.3	4.6	1.2	0.8	1.6	2.5
Long-term interest rate <sup>2</sup>	4.3	4.4	3.9	3.2	3.6	3.8
	Percentage changes from previous year					
<i>Effective exchange rate</i>						
Nominal	+ 1.1	+ 1.2	+ 0.9	- 2.5	+ 0.9	- 0.5
Real	+ 0.7	+ 0.6	+ 0.4	- 2.7	+ 1.5	- 0.1

Source: WIFO Economic Outlook. – <sup>1</sup> 10-year central government bonds (benchmark).

*Favourable business conditions lead to higher government revenues. By 2012, the general government deficit should fall below the Maastricht ceiling of 3 percent of GDP.*