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# Global Economic Crisis Striking Severely Also in Austria

## Economic Outlook for 2009 and 2010

**For the first time since World War II, the global economy is in recession. Demand and output will fall markedly in the world's major economic zones. Also Austria should experience a fall of GDP by 2.2 percent in real terms in 2009, despite fiscal policy taking massive counter-action. While exports and investment take a slump, private consumption withstands the recession with a further modest gain. In 2010, the cyclical support measures should prove effective also at the international level. With the fall in external demand bottoming out, economic activity in Austria should pick up by 0.5 percent.**

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Towards the end of 2008, the worldwide cyclical downturn gathered considerable momentum. Global output is expected to decline by 1 percent this year, with the downward trend extending to all economic zones. The USA, Japan and the EU are caught in a deep recession, and growth of the emerging economies which has been dynamic until recently is set to decelerate sharply. The stabilisation of financial markets, a necessary condition for the resumption of sustainable growth, has so far not materialised. As a result of the large-scale international measures to stabilise the business cycle, the world economy should nevertheless return to a moderate upward path in 2010.

The adverse international business situation is reflected also by a steep decline in world trade (by 5 percent in 2009) that has so far been an important driver of global expansion. After a sharp fall from mid-July to early December 2008, oil prices have stabilised in a range from \$ 40 to \$ 45 per barrel. Due to sluggish demand, prices will remain in that range on annual average 2009. While oil producers scale back their investments, demand for oil products will pick up somewhat in 2010, possibly driving up prices to \$ 55 per barrel. In view of the persisting uncertainties on financial markets and the different response of monetary policy in the USA and the euro area, projections of exchange rates are subject to a particularly wide margin of error. For the purpose of the present projections, an exchange rate assumption of \$ 1.25 per euro has been retained for both years.

Although the US economy is more severely affected by the financial market crisis, the setback in activity of an expected 2.7 percent will be somewhat smaller than that of the euro area of 3 percent. The more active economic policy stance in the USA plays a decisive role in this regard. Fiscal policy will support demand and output to the amount of \$ 600 billion (around 4 percent of GDP) in the next few years. Monetary policy can also give further incentives, even if the Fed cut its key interest rate to nearly 0 percent in December 2008. With open market interventions the Fed manages to increase money supply on a sustained basis.

In the EU, the crisis exacerbated markedly towards the end of 2008. Real GDP, having edged down already by a seasonally- and calendar-adjusted 0.1 percent and 0.3 percent in the second and third quarter, respectively, slumped by 1½ percent in the year-end period. Business surveys for the EU suggest a further fall of similar size for

the first quarter 2009. According to WIFO expectations, the downward trend should become flatter thereafter. Towards the end of the year, the counter-cyclical stimulus programmes should exert their full impact also in the EU, preventing a further decline of GDP in 2010.

As a small, export-oriented economy, Austria cannot withdraw from the negative international trend. In 2008, growth decelerated steadily from quarter to quarter, and at the end of the year the economy slipped also into recession. The regular WIFO business survey points to a marked acceleration of the downturn since the beginning of this year. As the stimulus "packages" and the income tax cuts will only be partially effective in 2009, the downward trend may not bottom out before the second half of the year. A major stabilising force will be private consumption which is set to remain slightly upward bound this year and next, despite the recession. Exports and investment, however, will drop sharply in 2009. In all, the Austrian economy will contract by 2.2 percent in 2009, less though than the entire euro area (-3 percent).

Table 1: Main results

		2005	2006	2007	2008	2009	2010
		Percentage changes from previous year					
<b>GDP</b>							
Volume		+ 2.9	+ 3.4	+ 3.1	+ 1.8	- 2.2	+ 0.5
Value		+ 5.0	+ 5.3	+ 5.3	+ 4.2	- 0.7	+ 1.3
Manufacturing <sup>1</sup> , volume		+ 4.8	+ 9.6	+ 5.5	+ 3.5	- 5.5	+ 0.5
Wholesale and retail trade, volume		+ 2.2	- 1.0	+ 1.5	- 0.0	- 1.5	+ 0.5
Private consumption expenditure, volume		+ 2.6	+ 2.4	+ 1.0	+ 0.9	+ 0.4	+ 0.8
Gross fixed investment, volume		+ 2.4	+ 2.6	+ 4.7	+ 1.8	- 5.1	+ 0.3
Machinery and equipment <sup>2</sup>		+ 5.5	+ 0.9	+ 6.8	+ 2.1	- 10.0	± 0.0
Construction		- 0.4	+ 4.2	+ 2.8	+ 1.5	- 1.0	+ 0.5
<b>Exports of goods<sup>3</sup></b>							
Volume		+ 3.2	+ 6.8	+ 8.7	+ 0.9	- 7.0	+ 0.5
Value		+ 5.4	+ 9.5	+ 10.5	+ 2.3	- 7.9	+ 1.2
<b>Imports of goods<sup>3</sup></b>							
Volume		+ 2.9	+ 4.1	+ 8.0	+ 1.7	- 5.0	+ 0.3
Value		+ 5.9	+ 8.0	+ 9.6	+ 4.3	- 6.9	+ 1.8
Current balance	billion €	+ 4.92	+ 7.26	+ 8.56	+ 8.17	+ 4.61	+ 3.76
As a percentage of GDP		+ 2.0	+ 2.8	+ 3.2	+ 2.9	+ 1.6	+ 1.3
Long-term interest rate <sup>4</sup>	in percent	3.4	3.8	4.3	4.3	3.8	3.8
Consumer prices		+ 2.3	+ 1.5	+ 2.2	+ 3.2	+ 0.6	+ 1.1
<b>Unemployment rate</b>							
Eurostat definition <sup>5</sup>	in percent	5.2	4.8	4.4	3.8	5.0	5.8
National definition <sup>6</sup>	in percent	7.3	6.8	6.2	5.8	7.3	8.2
Persons in active dependent employment <sup>7</sup>		+ 1.0	+ 1.7	+ 2.1	+ 2.4	- 1.2	- 0.6
<b>General government financial balance according to Maastricht definition</b>							
As a percentage of GDP		- 1.5	- 1.5	- 0.4	- 0.3	- 3.5	- 4.0

Source: WIFO Economic Outlook. – <sup>1</sup> Value added, including mining and quarrying. – <sup>2</sup> Including other products. – <sup>3</sup> According to Statistics Austria. – <sup>4</sup> 10-year central government bonds (benchmark). – <sup>5</sup> According to Eurostat Labour Force Survey; 2008: break. – <sup>6</sup> According to Public Employment Service Austria, as a percentage of total labour force excluding self employed. – <sup>7</sup> Excluding parental leave, military service, and unemployed persons in training.

Against the background of worldwide cyclical sluggishness, inflation in Austria is moderating swiftly. On annual average 2009, the consumer price index is projected to edge up by only 0.6 percent. During the summer months, negative rates may even be recorded. The massive increase in money supply substantially reduces the risk of deflation being triggered by the world recession. For 2010, WIFO expects headline inflation to go up slightly to an annual rate of 1.1 percent, while core inflation should remain stable at a low level.

The recession will lead to a sharp deterioration on the Austrian labour market. WIFO expects the number of unemployed to rise by 53,000 or 25 percent in 2009, to a total 265,000. At the same time, employment will fall by 38,000 or 1.2 percent. The jobless rate according to national definitions will rise to 7.3 percent of the dependent labour force. Since the labour market usually lags the cycle of demand and output, it will not yet benefit from the stabilisation in 2010. Unemployment will thus rise by a further 33,000 persons, as a consequence of another 20,000 jobs being lost. The unemployment rate will reach 8.2 percent.

The crisis in the USA financial sector has still not been overcome. Real estate prices continued to fall by the end of 2008 such that the collateral of mortgage-backed securities diminished further. Banks and insurance companies still struggle with liquidity constraints, and policy remains faced with the need of massive rescue measures. In 2008, GDP still grew by 1.1 percent on the back of powerful fiscal stimulus. In 2009, major support comes from monetary expansion although its impact on aggregate demand is substantially smaller than that of fiscal policy. The stimulus "package" recently adopted by the new US administration will exert its full impact only as from 2010. For 2009, WIFO therefore expects US GDP to decline by 2.7 percent in volume. In 2010, the comprehensive stimulus measures should allow growth to resume at a modest 0.5 percent rate.

## Global economy in recession

*In 2008, the world economy expanded by 2.5 percent, only half the rate of the previous year. In 2009, global output may actually fall for the first time since World War II. The economies of the USA, Japan and the EU have entered a recession, and growth of the emerging markets which has been dynamic until recently is set to decelerate sharply.*

Table 2: World economy

	2005	2006	2007	2008	2009	2010
	Percentage changes from previous year					
<i>Real GDP</i>						
World	+ 4.5	+ 5.1	+ 5.2	+ 2.5	- 1.0	+ 1.7
Total OECD	+ 2.7	+ 3.1	+ 2.7	+ 0.9	- 3.0	+ 0.3
USA	+ 2.9	+ 2.8	+ 2.0	+ 1.1	- 2.7	+ 0.5
Japan	+ 1.9	+ 2.0	+ 2.4	- 0.7	- 4.5	+ 0.5
EU 27	+ 2.0	+ 3.1	+ 2.9	+ 0.9	- 3.0	± 0.0
Euro area 16	+ 1.7	+ 2.9	+ 2.7	+ 0.8	- 3.0	± 0.0
New EU countries <sup>1</sup>	+ 4.7	+ 6.5	+ 6.0	+ 4.0	± 0.0	+ 1.0
China	+ 10.4	+ 11.6	+ 13.0	+ 9.0	+ 5.0	+ 7.0
<i>World trade, volume</i>	+ 7.6	+ 8.8	+ 6.2	+ 4.0	- 5.0	+ 3.0
<i>Market growth<sup>2</sup></i>	+ 7.8	+ 11.1	+ 7.6	+ 3.8	- 7.5	± 0.0
<i>Primary commodity prices</i>						
HWVA index, total	+ 28.5	+ 19.7	+ 3.7	+ 22.4	- 31	+ 15
Excluding energy	+ 5.6	+ 22.0	+ 9.5	+ 15.6	- 15	+ 5
<i>Crude oil prices</i>						
Brent, \$ per barrel	54.4	65.1	72.5	97.0	45	55
<i>Exchange rate</i>						
\$ per euro	1.245	1.256	1.371	1.471	1.25	1.25

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

Although the US economy is deemed to perform somewhat better than the euro area, this is entirely due to the extraordinarily expansionary policy stance. Indeed, while the US budget deficit is projected to widen to over 10 percent of GDP in 2009, the corresponding expectation for the euro area is for a ratio less than half that size. Monetary policy also is reacting much more strongly in the USA than in the euro area: already in December 2008, the Federal Reserve cut its key interest rate to close to 0 percent. For a further increase in money supply it now has to rely on open market operations. To this end, the Federal Reserve already announced in March 2009 its intention to purchase mortgage-backed securities for \$ 750 billion and government bonds for \$ 300 billion on the primary market. The latter amounts to direct financing of government debt which is excluded by ESCB legislation for the euro area.

The present crisis hits particularly strongly the export-oriented economies like Japan whose GDP in the fourth quarter 2008 fell by 3.2 percent from the previous period.

The slump is even stronger than after the burst of the real estate bubble in the early 1990s. The situation is unlikely to have improved in the first quarter 2009. In January, merchandise exports were 46.3 percent below the year-earlier level. Given the worldwide decline in inflation, a relapse of the Japanese economy into deflation appears very likely. WIFO expects GDP to drop by 4.5 percent in the current year.

Because of its extraordinarily high degree of openness, the Chinese economy suffers likewise from the current crisis. In January and February 2009, goods exports fell by an average over 20 percent year-on-year. The central government has, however, sufficient financial leeway to counter the negative trend by large-scale fiscal stimulus. Far-reaching investment programmes have already been announced, and incentives are also to be given to private household demand. WIFO nevertheless expects a sharp deceleration of real GDP growth from 9 percent in 2008 to 5 percent this year. A rebound may be expected only for 2010.

Having edged down already in the second and third quarter, euro area GDP caved in towards the end of the year when it fell by a seasonally- and calendar-adjusted 1.5 percent from the previous period. The decline in the fourth quarter extended to all major EU economies (France -1.2 percent, Spain -1.0 percent, Italy -1.8 percent). The German economy, shrinking by 2.1 percent in the fourth quarter, was particularly hard hit by the shortfall in external demand. Against this background, the countries in the euro area reinforced their cyclical stimulus efforts that until then had been rather timid and poorly co-ordinated. Germany and France stepped up their "packages" adopted earlier. Fiscal policy action in the EU remains limited nevertheless: the positive effect on GDP for 2009 is estimated at less than 1 percentage point, as compared with an impulse of 2 percentage points in the USA and even of 7 points in China.

Also as far as monetary policy action is concerned, the euro area is trailing clearly behind the USA. Whereas the Federal Reserve has cut its key intervention rate down to almost 0 percent since the middle of last December, the ECB lowered its reference rate only to 1.5 percent in early March. It is true, however that unlike in the USA the euro area shows so far no signs of credit squeeze that would exceed the normal pattern in the current phase of the cycle.

A convergence of long-term interest rates between the members of the euro area was observed already in the run-up to EMU. It continued thereafter, and only small differentials remained before the onset of the current financial market crisis. The counter-cyclical programmes in response to the crisis, the bank rescue packages as well as the recession-induced tax revenue shortfalls raise doubts with many market participants concerning the creditworthiness of some countries in the euro area. Since October 2008, risk premia for government bond yields have widened vis-à-vis German bonds for many countries.

The present forecast assumes that GDP in the euro area will fall at the same pace in the first quarter 2009 as in the previous period, an assumption warranted by the results of the latest business surveys. In the further course of the year, however, the downward trend should flatten markedly, bottoming out around the turn of the year 2009-2010. As the fiscal stimulus programmes are to show increasingly stronger effects, economic activity in 2010 should no longer fall below the year-earlier level.

With the financial market crisis, the swift catching-up process in East-central Europe is grinding to a halt. While the economies of the eight new EU countries which are not yet part of the euro area expanded by nearly 4 percent overall in 2008, the upward trend is likely to level off in 2009, resulting in stagnation of GDP at the year-earlier level. Because of the continued distrust among financial market participants, the past months have seen considerable capital outflows from the area, exposing the currencies of several countries to strong downward pressure. This process may continue and hit the real economy of these countries more strongly than up to now.

In the fourth quarter 2008, demand and output receded in Hungary and the Czech Republic and lost substantial momentum in Poland, the largest economy in the region.

### **Crisis hitting in particular the European economies**

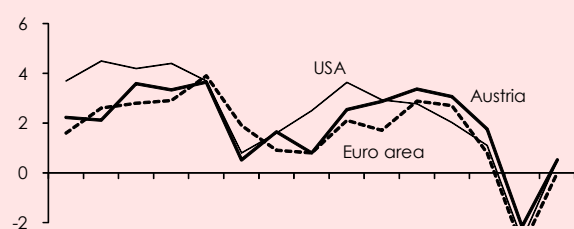
*In Europe there have so far been no clear signs of credit constraints. The recessionary forces derive rather from the real economy, with exports suffering in the first place. For the highly export-oriented economies, the economic crisis has therefore serious negative consequences.*

*The financial market crisis creates major problems for the countries in East-central Europe which rely on funds from abroad for financing their catching-up process. GDP growth in the area will come to a halt and still not have resumed its earlier pace by 2010.*

Figure 1: Indicators of economic performance

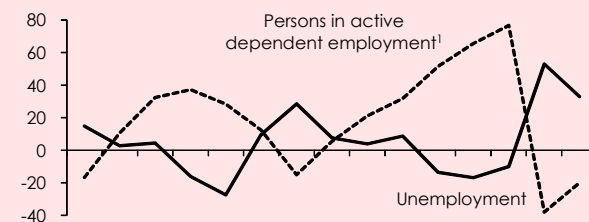
## Growth of real GDP

Percent



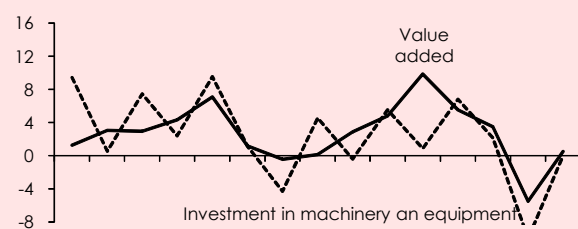
## Employment and unemployment

1,000 from previous year



## Manufacturing and investment

Percentage changes from previous year, volume



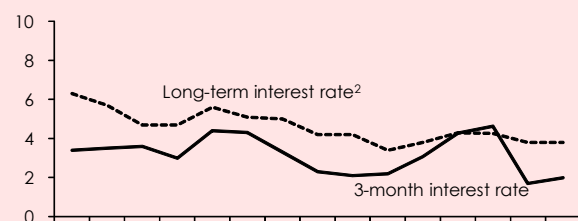
## Consumption and income

Percentage changes from previous year, volume



## Short-term and long-term interest rates

Percent



## Inflation and unit labour costs

Percentage changes from previous year



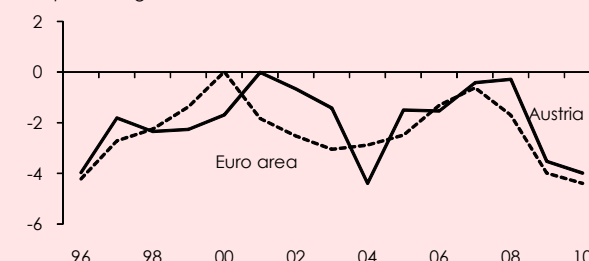
## Trade

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).

Since Austrian banks hold substantial credit claims vis-à-vis these countries, developments in this geographic area are of crucial importance for the domestic economy. Yet, business operations conducted by Austrian financial institutions were so far concentrated on retail banking transactions where financial losses should remain circumscribed even under most adverse economic conditions. In the event of default of debtors there would be the option of rescheduling of debt providing for deferred redemption. Since the region of East-central Europe can be expected to later return to dynamic economic growth, such a strategy may seem promising.

A greater risk for the Austrian economy derives from the shortfall in real demand for goods and services from these countries. Austrian exports to this area accounted for some 18 percent of the total in 2008. In addition, the area has become increasingly important for the domestic tourism industry. The growth impulse that the Austrian economy received during the last few years from these countries' economic boom will be lacking over the entire projection period.

The pace of growth decelerated in Austria already during 2008. In the fourth quarter, real GDP edged down by 0.2 percent from the previous period, implying the entry of the economy into recession. While the decline has been relatively small so far when compared with other countries, the WIFO business survey points to a rapidly deteriorating situation since the beginning of 2009.

Since the Austrian economy is highly export-oriented and with its major trading partners Germany and the countries in East-central Europe being to an above-average degree affected by the crisis, Austria is likely to also suffer a severe economic recession. The negative swing in the growth rate from 2008 will thus be slightly higher than for the euro area average (4 versus 3.8 percentage points). Due to its previous growth advantage and a larger fiscal stimulus, the fall in domestic activity should be limited to 2.2 percent. A key role in this context plays private consumption which despite the gloomy overall situation is set to remain upward bound until the forecast horizon.

Exports will slump markedly in 2009, with goods being more negatively affected (-7 percent in volume) than tourism services (-5 percent). In 2010, at least foreign demand for Austrian goods should resume providing positive incentives to domestic activity. Tourism exports, for their part, are likely to decline further. Also investment is receding with the gloomy economic prospects. The negative projection is dominated by a 10 percent slump in demand for new machinery and equipment, while construction investment, benefiting from resilient demand for new infrastructure, should lose only 1 percent in 2009. In 2010, the cyclical stimulus measures should allow GDP growth to resume at a modest rate of 0.5 percent.

Austrian merchandise exports lost progressively momentum in the course of 2008. From October to December, a decline was recorded even in a year-on-year comparison. The greatest losses occurred in trade with other euro area countries, even if negative results extended to other areas as well. According to the latest WIFO business survey, the downward trend has markedly accelerated since the beginning of 2009. In the annual comparison, exports of goods will fall at double-digit rates in the months to come. For the whole year 2009, the loss will reach 8 percent in nominal and 7 percent in real terms. A revival of demand on the back of the international fiscal stimulus programmes should lead to a tentative pick-up of Austrian exports by 0.5 percent in volume in 2010.

The global demand recession strikes most severely the highly export-oriented manufacturing industry. As the business surveys show, all branches feel the adverse impact. Demand is receding massively not only for motor vehicle components, but also for primary inputs, investment goods and consumer durables. Business conditions are expected to worsen also in the food, beverages and tobacco industry.

Many firms struggle with considerable excess productive capacities and are compelled to lay off workers or resort to government-subsidised short-time work arrangements. In March 2009, the number of short-time workers climbed to 42,000. Job losses in manufacturing should thereby be limited to a rate of 4.5 percent. This should help avoid the waste of important job qualifications which will be needed once the crisis has ended. Manufacturing value added is projected to fall by 5.5 percent in 2009, followed by a timid recovery of 0.5 percent in 2010.

### **Austria's economy contracting markedly in 2009**

*The Austrian economy, like others, slipped into recession in 2008. In the current year, demand and output are expected to fall by 2.2 percent. This has negative repercussions for the labour market where employment is set to decline by 1.2 percent this year, driving unemployment up to a rate of 7.3 percent.*

### **Export slump weighing on manufacturing output**



Table 3: Productivity

	2005	2006	2007	2008	2009	2010
	Percentage changes from previous year					
<i>Total economy</i>						
Real GDP	+ 2.9	+ 3.4	+ 3.1	+ 1.8	- 2.2	+ 0.5
Employment <sup>1</sup>	+ 1.1	+ 1.5	+ 1.7	+ 1.6	- 1.2	- 0.5
Productivity (GDP per employment)	+ 1.7	+ 1.9	+ 1.3	+ 0.1	- 0.9	+ 1.1
<i>Manufacturing</i>						
Production <sup>2</sup>	+ 4.8	+ 9.9	+ 5.5	+ 3.5	- 5.5	+ 0.5
Employees <sup>3</sup>	- 0.8	+ 0.2	+ 2.6	+ 1.6	- 4.5	- 2.6
Productivity per hour	+ 6.2	+ 9.5	+ 3.2	+ 2.4	+ 0.5	+ 3.2
Working hours per day per employee <sup>4</sup>	- 0.6	+ 0.2	- 0.3	- 0.5	- 1.5	± 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.

The recession will lead to output losses in almost all sectors of the Austrian economy this year. WIFO expects modest gains only for the production of public and private services.

In the regular WIFO business survey conducted during 2008, companies showed themselves increasingly pessimistic on the short-term prospects. The weakening confidence weighed on investment already in 2008: according to preliminary figures, gross fixed investment for the whole year rose by only 1.8 percent in volume above the 2007 level, compared with a gain of 4.7 percent recorded for that year. For 2009, spending on fixed capital is projected to drop by 5.1 percent at constant values, whereby the slump will be much more severe for purchases of machinery and equipment (-10 percent) than for construction investment which should benefit from government support programmes. The introduction of an accelerated depreciation allowance included in the "cyclical stimulus package II" adopted by the Federal government will be of limited impact; a relatively stronger demand effect already in 2009 is to be expected from carried-forward investment projects of the public railway (ÖBB) and the Federal real estate company (BIG), the publicly-subsidised insulation of buildings and the creation of new child-care facilities.

In order to examine whether the increase in risk awareness with the current financial market crisis is constraining companies' access to credit, the questionnaire of the WIFO business survey has been supplemented accordingly. While early results are not yet available, official credit statistics do not give indications of a credit squeeze. In several branches, large-size companies nevertheless report having difficulties with obtaining credit for current operations or with issuing bonds. Also financing costs are reported to have increased markedly. Yet, generally speaking, domestic companies appear to struggle more with the setback in real demand than with financial constraints.

After a successful year 2008, domestic tourism services posted further gains in early 2009, owing to favourable weather conditions. Sales increased by a nominal 6.6 percent in 2008 and by 3.3 percent in real terms. In January 2009, the number of overnight stays rose 2.4 percent above the year-earlier level. Later in the first quarter, developments turned markedly less benign. Urban tourism, which is less influenced by weather conditions, suffered first setbacks in January and February (-10 percent in Vienna in February).

Private households are not expected to refrain entirely from travelling in reaction to the economic crisis, but shift their preferences in favour of geographically closer destinations. Austria, being attractive and by car easily accessible for neighbouring countries, may benefit from such shift. While this may dampen the fall in demand, the domestic tourism sector will nevertheless suffer a severe setback, with exports expected to drop by 5 percent in volume from last year. Given that the labour market usually reacts with a lag to the cycle of demand and output, the negative trend may extend into 2010 (albeit with a flatter profile) even if overall economic condi-

As indicated by the regular WIFO business and investment surveys, almost all branches of manufacturing are severely affected by the recession. The steep fall in external demand is prompting more and more firms to resort to short-time work arrangements.

### Gloomy prospects weighing on business fixed investment

The recession-induced excess production capacities compel firms to drastically cut their investment plans. However, a special investigation in the context of the WIFO business survey reveals that only few companies face problems of credit availability.

### Major losses in tourism

The rise in unemployment and slower private income growth will dampen markedly the demand for travel at the international level. Although the Austrian tourism sector stands to gain market shares, demand will fall sharply this year and probably, albeit to a lesser extent, in 2010.

tions start picking up. As long as uncertainty dominates the labour market, demand for travel is bound to remain subdued.

In 2009, real disposable income of private households is benefiting from several favourable factors: the wage settlements concluded in 2008, the income tax reform as well as the moderation of inflation. In addition, several social transfers (e.g., the 13th annual instalment of the family allowance) will increase household income in 2009 and 2010. On the negative side, there is the decline in employment and losses in interest and dividend income as a consequence of the financial market crisis. While real earnings from employment will increase by 3.6 percent on a net basis per capita, real disposable household income will only edge up by 1.2 percent overall.

### Fiscal policy action supporting private consumption

While earnings from employment are boosted by the wage settlements for 2009 and income tax cuts, financial capital losses will dampen overall disposable income. The swift deceleration of inflation is strengthening private households' purchasing power. Against this background, private consumption will edge up by an inflation-adjusted 0.4 percent, with the tax cuts preventing a decline.

Table 4: Private consumption, income and prices

	2005	2006	2007	2008	2009	2010	
	Percentage changes from previous year						
Private consumption expenditure	+ 2.6	+ 2.4	+ 1.0	+ 0.9	+ 0.4	+ 0.8	
Durables	+ 5.9	+ 7.0	+ 6.2	- 1.0	- 3.8	- 0.3	
Non-durables and services	+ 2.2	+ 1.9	+ 0.4	+ 1.1	+ 0.9	+ 0.9	
Household disposable income	+ 3.1	+ 3.5	+ 2.2	+ 0.8	+ 1.2	+ 0.4	
Household saving ratio	9.8	As a percentage of disposable income					
		10.8	11.7	11.5	12.2	11.8	
Direct lending to domestic non-banks <sup>1</sup>	+ 4.7	Percentage changes from previous year					
		+ 4.5	+ 3.6	+ 7.4	- 1.0	± 0.0	
Inflation rate	Percentage changes from previous year						
National	2.3	1.5	2.2	3.2	0.6	1.1	
Harmonised				3	0	1	
Core inflation <sup>2</sup>	2.1	1.7	2.2	2	6	1	
	1	1	1	2	1	1	
	5	3	9	4	4	2	

Source: WIFO Economic Outlook. – <sup>1</sup> End of period. – <sup>2</sup> Excluding unprocessed food (meat, fish, fruits, vegetables) and energy items.

Table 5: Earnings and international competitiveness

	2005	2006	2007	2008	2009	2010
	Percentage changes from previous year					
Gross earnings per employee <sup>1</sup>	+ 2.4	+ 3.2	+ 2.3	+ 3.0	+ 2.7	+ 1.2
Gross real earnings per employee <sup>1</sup>	+ 0.1	+ 1.4	+ 0.1	+ 0.1	+ 2.1	+ 0.1
Net real earnings per employee <sup>1</sup>	+ 0.5	+ 1.2	- 0.1	- 0.3	+ 3.6	- 0.2
Total economy						
Unit labour costs	+ 0.7	+ 1.1	+ 0.8	+ 2.9	+ 4.0	+ 0.1
Manufacturing						
Unit labour costs	- 0.9	- 4.4	- 0.6	+ 1.3	+ 3.5	- 1.4
Effective exchange rate, manufactures						
Nominal	- 0.6	+ 0.2	+ 1.2	+ 1.2	- 1.0	± 0.0
Real	- 0.9	- 0.4	+ 0.8	+ 0.6	- 1.2	- 0.3

Source: WIFO Economic Outlook. – <sup>1</sup> Employees according to National Accounts definition.

Private consumption in 2009 will only partially benefit from the favourable income trend. Gains from the income tax reform will reach households only by the middle of the year and will translate into higher spending with a lag of one or two quarters. Thus, part of the income gains will boost the saving ratio, projected to edge up from 11.5 percent in 2008 to 12.2 percent in 2009. Private consumption will nevertheless go up by an inflation-adjusted 0.4 percent, thereby providing cyclical support even in the face of the deteriorating economic and labour market situation. When in 2010



a larger part of the income gains will be spent, private consumption will increase by 0.8 percent accompanied by a decline in the saving ratio.

In 2008, high prices for commodities and for agricultural products drove inflation in Austria up to a long-time high. Since then, the year-on-year rate has abated, from 3.9 percent in June 2008 to 1.2 and 1.3 percent respectively, in January and February 2009.

In the months to come, price pressure should ease further and may even turn negative temporarily since part of the steep fall in oil prices (for the benchmark quality of Brent from \$ 144 per barrel in mid-July 2008 to \$ 40-45 since early December) still has to reach the consumer.

Although it is clearly possible that the current economic situation give rise to deflationary tendencies, the probability of negative inflation rates on a sustained basis is nevertheless low in view of the large-scale global increase in money supply by the central banks. It is equally unlikely that the massive money supply growth will trigger a spell of hyperinflation since a necessary condition for this to occur, i.e., an overheating private consumption boom, has so far not been detected.

The labour market reacted unusually quickly to the current cyclical downturn. Ever since April 2008, the month-on-month comparison of the seasonally-adjusted data has shown a stagnation of employment followed by a fall since last October. At the same time, seasonally-adjusted unemployment is rising at increasing momentum from a trough reached in March 2008. The year-on-year comparison shows a fall in employment for the first time in February 2009 (-0.7 percent) and an increase in unemployment since November 2008.

## Inflation virtually coming to a halt

*The substantial fall in prices for raw materials and agricultural products coupled with the global recession make for a virtually stable overall price level. Headline inflation is thereby set to fall to 0.6 percent in 2009, the lowest rate in ten years.*

## Strong rise in unemployment

*Since the beginning of 2009, the situation on the Austrian labour market has worsened significantly. The number of persons employed will recede by 38,000 this year, the number of jobless people will go up by 53,000. The unemployment rate will reach 7.3 percent of the dependent labour force.*

Table 6: Labour market

		2005	2006	2007	2008	2009	2010
		Changes from previous year, in 1,000					
<i>Demand for labour</i>							
Persons in active employment <sup>1</sup>		+ 37.2	+ 55.9	+ 66.9	+ 85.7	- 39.0	- 19.0
Employees <sup>2</sup>		+ 31.9	+ 51.5	+ 65.5	+ 76.7	- 38.0	- 20.0
Percentage changes from previous year		+ 1.0	+ 1.7	+ 2.1	+ 2.4	- 1.2	- 0.6
Nationals		+ 20.0	+ 35.0	+ 43.6	+ 53.2	- 34.5	- 18.5
Foreign workers		+ 11.9	+ 16.5	+ 21.9	+ 23.5	- 3.5	- 1.5
Self-employed <sup>3</sup>		+ 5.3	+ 4.4	+ 1.4	+ 9.0	- 1.0	+ 1.0
<i>Labour supply</i>							
Population of working age	15 to 64 years	+ 15.6	+ 18.5	+ 17.4	+ 24.9	+ 20.2	+ 27.6
	15 to 59 years	+ 48.5	+ 52.8	+ 18.8	+ 15.7	+ 13.6	+ 13.7
Labour force <sup>4</sup>		+ 45.9	+ 42.4	+ 50.0	+ 75.7	+ 14.0	+ 14.0
<i>Surplus of labour</i>							
Registered unemployed <sup>5</sup>		+ 8.8	- 13.5	- 16.9	- 10.0	+ 53.0	+ 33.0
In 1,000		252.7	239.2	222.2	212.3	265.3	298.3
Unemployed persons in training	In 1,000	48.6	57.5	52.7	50.5	57.5	65.5
		Percent					
<i>Unemployment rate</i>							
Eurostat definition <sup>6,7</sup>		5.2	4.8	4.4	3.8	5.0	5.8
As a percentage of total labour force <sup>5</sup>		6.5	6.1	5.6	5.3	6.6	7.3
National definition <sup>5,8</sup>		7.3	6.8	6.2	5.8	7.3	8.2
<i>Employment rate</i>							
Persons in active employment <sup>1,9</sup>		62.8	63.6	64.5	65.8	64.9	64.2
Total employment <sup>6,9</sup>		68.6	70.2	71.4	72.3	71.2	70.5

Source: WIFO Economic Outlook. – <sup>1</sup> Excluding parental leave, military service, and unemployed persons in training. – <sup>2</sup> According to Federation of Austrian Social Security Institutions. – <sup>3</sup> According to WIFO. – <sup>4</sup> Economically active employment plus unemployment. – <sup>5</sup> According to Public Employment Service Austria. – <sup>6</sup> According to Eurostat Labour Force Survey. – <sup>7</sup> 2008: break. – <sup>8</sup> As a percentage of total labour force, without self-employed. – <sup>9</sup> As a percentage of population of working age (15 to 64 years).

In view of the spreading excess in productive capacities, firms readily made use of the option of government-subsidised short-time work. In March 2009, as many as 42,000 persons benefited from this scheme. In this way it can be avoided that impor-

tant qualifications are lost and shortages of qualified labour emerge in a subsequent cyclical upturn. The number of people in dependent employment will nevertheless drop by 38.000 or 1.2 percent this year, while the jobless figure will go up by 53.000 or 25 percent. The situation will hardly improve in 2010 when employment is expected to fall by another 20.000 or 0.6 percent and unemployment to climb by 33,000.

In these circumstances, the unemployment rate as defined by traditional national criteria will move up from 5.8 percent in 2008 to 7.3 percent in 2009 and 8.2 percent by 2010. This would be the highest rate in over 20 years.

Given that the draft Federal budget for 2009 and 2010 will only be submitted in April 2009, the budgetary projections are surrounded by a wide margin of uncertainty. WIFO retains its assumptions from the projections of last December which already included most of the discretionary measures taken. Heavier than expected earlier is, however, the budgetary burden implied by the recession, such as the shortfall in growth-related tax revenues or higher claims to unemployment benefits.

### Budget deficit driven up by cyclical downturn and fiscal policy action

*With a projected general government deficit of 3.5 percent of GDP in 2009 and 4 percent in 2010, the ceiling of 3 percent as defined in the European Stability and Growth Pact will be exceeded also in Austria.*

Table 7: Key policy indicators

	2005	2006	2007	2008	2009	2010
	As a percentage of GDP					
<i>Fiscal policy</i>						
<i>General government financial balance</i>						
According to Maastricht definition	- 1.5	- 1.5	- 0.4	- 0.3	- 3.5	- 4.0
According to National Accounts	- 1.6	- 1.7	- 0.5	- 0.4	- 3.5	- 4.1
General government primary balance	+ 1.4	+ 1.2	+ 2.3	+ 2.5	- 0.5	- 1.0
	Percent					
<i>Monetary policy</i>						
3-month interest rate	2.2	3.1	4.3	4.6	1.7	2.0
Long-term interest rate <sup>1</sup>	3.4	3.8	4.3	4.3	3.8	3.8
	Percentage changes from previous year					
<i>Effective exchange rate</i>						
Nominal	- 0.7	+ 0.2	+ 1.1	+ 1.2	- 1.0	± 0.0
Real	- 1.0	- 0.5	+ 0.7	+ 0.6	- 1.2	- 0.3

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

On the basis of these assumptions, the general government balance will deteriorate significantly, to a deficit of 3.5 percent of GDP in 2009 and 4 percent in 2010. Austria will thereby exceed, like most other EU countries, the deficit ceiling of 3 percent as defined in the European Stability and Growth Pact. Yet, in these extraordinary economic circumstances the action taken by fiscal policy contributes importantly towards sustaining domestic activity and is therefore deemed necessary. Over the medium term, efforts should nevertheless be resumed to consolidate public finances. In this context, the administrative reform may play a key role.