

Josef Baumgartner, Serguei Kaniovski, Hans Pitlik

Gradual Recovery Following Severe Recession

Medium-Term Projections for the Austrian Economy until 2014

In the aftermath of the deepest recession since the 1930s gross domestic product in Austria will increase by an average of 1.8 percent per year in 2010 to 2014, which is $\frac{3}{4}$ percentage point lower than the average of the past decade. The growth advantage vis-à-vis the average of the euro area will diminish significantly, not least because the weak growth of export to Central and Eastern Europe and the fragility of the financial sector. The recession will have a lasting effect on the labour market and public finances. Inflation, however, will remain low. From 2011 onwards budget consolidation measures will reduce the budget deficit but dampen aggregate demand.

Josef Baumgartner, Serguei Kaniovski and Hans Pitlik are economists at WIFO. The authors are grateful to Karl Aiginger, Markus Marterbauer and Margit Schratzenstaller for helpful and constructive comments. • The data were processed and analysed with the assistance of Christine Kaufmann. • E-mail addresses: Josef.Baumgartner@wifo.ac.at, Serguei.Kaniovski@wifo.ac.at, Hans.Pitlik@wifo.ac.at, Christine.Kaufmann@wifo.ac.at

At the end of 2008, the global financial and economic crisis triggered the deepest recession since the 1930s. Past recessions show that a combination of financial and economic crisis is likely to slow the pace of the subsequent economic recovery (IMF, 2009A). Owing to an unprecedented fiscal and monetary response in all major economies, the global economic slump seems to have reached a halt in mid-2009. From 2010 a recovery can be expected. At 1.8 percent per year the Austrian economy will expand by $\frac{3}{4}$ percentage point more slowly than in the 10 years preceding the economic crisis of 2009 (+2½ percent per year)¹. Even at the cyclical peak of the forecast horizon (2012 to 2014) GDP growth will not reach this average. The world economy will overcome the consequences of the financial crisis only very gradually. The provision of venture capital and loans to the private sector for investment in machinery and equipment and construction as well as consumption expenditure remains low. Potential output growth will no longer keep the pace of the past (Gaggl – Janger, 2009, European Commission, 2009A, IMF, 2009B). Austria's growth advantage vis-à-vis the average of the euro area will diminish, not least because exports to Central and Eastern Europe are expected to lose momentum.

To counter the effects of the international financial and economic crisis, policy-makers in Austria brought the tax reform forward into 2009 and passed two economic recovery and two labour market packages. As some of the larger construction projects could not yet be implemented, their effect should contribute to the upswing in 2010. The Austrian economy also benefited from the economic stimulus measures taken by its EU neighbours within the framework of the "European Economic Recovery Plan (EERP)", and by other major trade partners such as the USA and Switzerland. Breuss – Kaniovski – Schratzenstaller (2009) estimate the spillover effect as roughly comparable to that of the measures taken by the Austrian federal government (including quasi-public enterprises).

Unlike in most other countries of the euro area, the trend of real disposable household income, which was favoured by the tax reform, low inflation, high wage in-

¹ The growth forecast of 2010 and 2011 is in line with the WIFO's short-term forecast of December 2009. For the following years medium-term trends were estimated.

creases in 2008, increase of transfers to households, increased private consumption in Austria in 2009 (+½ percent). However, a larger fraction of the income increase than in previous years was saved. During the forecast period 2010 to 2014 an average increase of consumption of 1 percent is expected – ½ percentage point below the average of the five years before the crisis. The forecast assumes that the savings ratio of private households will gradually decline again.

Table 1: Main results

	Ø 1998-2008	Ø 2003-2008	Ø 1999-2004	Ø 2004-2009	Ø 2009-2014	2009	2010	2011	2012	2013	2014
	Year-to-year percentage changes										
Gross domestic product											
Volume	+ 2.4	+ 2.8	+ 1.8	+ 1.6	+ 1.8	- 3.4	+ 1.5	+ 1.6	+ 2.0	+ 2.0	+ 1.9
Value	+ 4.0	+ 4.8	+ 3.3	+ 3.6	+ 3.1	- 1.7	+ 2.1	+ 2.9	+ 3.4	+ 3.6	+ 3.5
Consumer prices	+ 2.0	+ 2.2	+ 2.0	+ 1.9	+ 1.6	+ 0.5	+ 1.3	+ 1.5	+ 1.7	+ 1.9	+ 1.8
Gross wages and salaries per employee ¹	+ 2.3	+ 2.6	+ 2.0	+ 2.7	+ 2.1	+ 2.3	+ 1.2	+ 1.9	+ 2.4	+ 2.5	+ 2.6
Active dependent employment ²	+ 1.0	+ 1.6	+ 0.3	+ 1.2	+ 0.4	- 1.3	- 0.3	+ 0.3	+ 0.6	+ 0.7	+ 0.7
	Ø 1999-2008	Ø 2004-2008	Ø 2000-2004	Ø 2005-2009	Ø 2010-2014	2009	2010	2011	2012	2013	2014
	In percent										
Unemployment rate											
Eurostat definition ³	4.3	4.6	4.1	4.6	5.6	5.0	5.4	5.7	5.7	5.7	5.6
National definition ⁴	6.6	6.6	6.6	6.7	8.1	7.1	7.7	8.1	8.2	8.2	8.2
	As a percentage of GDP										
Net exports	3.8	4.8	3.2	5.0	5.3	4.6	4.8	5.2	5.4	5.5	5.5
General government financial balance (Maastricht definition)	- 1.5	- 1.7	- 1.6	- 1.7	- 4.0	- 4.2	- 5.2	- 4.8	- 4.2	- 3.4	- 2.5
	As a percentage of disposable income										
Household saving ratio	9.7	10.6	8.7	11.4	12.4	13.0	12.9	12.6	12.5	12.2	12.0

Source: Statistics Austria, WIFO calculations. – ¹ Excluding employers' contributions, employees according to National Accounts definition. – ² Excluding parental leave, military service, and unemployed persons in training. – ³ According to Eurostat Labour Force Survey, percent of total labour force. – ⁴ According to Public Employment Service, percent of total labour force excluding self-employed.

Real net exports will spur economic growth in the forecast period. The export forecast is based on the assumption that the world economy will gradually overcome the effects of the financial crisis on the real economy and that a recovery, supported by the worldwide stimulus programmes and low interest rates, will set in in 2010. The revival of global trade will cause an increase of the Austrian exports by an average of 5½ percent per year, almost 1 percentage point less than in the ten years preceding the crisis. Due to the very low capacity utilisation, the rebound of exports will not yet bring about any recovery of investment activity. During the whole forecast period investment is expected to grow on average by 2 percent per year.

Owing to the recession, unemployment reached the highest level since the mid-1950s in 2009. Although the extension of short-time working schemes, training and educational leave slowed the increase in the number of unemployed persons in 2009 by about 13,000, unemployment will remain the main policy concern in the coming years (Mahringer, 2009). From 2008 until 2014 the number of registered unemployed persons is expected to rise by slightly more than 90,000 to above 300,000. On average during the years 2010 to 2014 the unemployment rate (as defined by the Public Employment Service, AMS) is expected to reach 8.1 percent. However, in the case of a less favourable economic trend unemployment would rise even faster. Employment will increase by 0.4 percent per year in 2010 to 2014, but full-time employment is not expected to pick up until the end of the forecast period. The free movement of qualified workers from the new EU countries since 2009 and the expiry of the transition period in 2011 will increase the flow of commuters and migrants. However, the scope of migration depends, above all, on domestic labour demand.

The fall in government revenues in the wake of the crisis and the tax reform as well as the increase of government spending due to the recession will raise the general government deficit to 5¼ percent of GDP in 2010. In addition to a cyclical improve-

ment, measures to consolidate the budget will have to be taken, if the deficit ratio is to be reduced below 3 percent of GDP by 2014.

Figure 1: Cyclical downturns in Austria since 1970

Real GDP, percentage changes from previous year

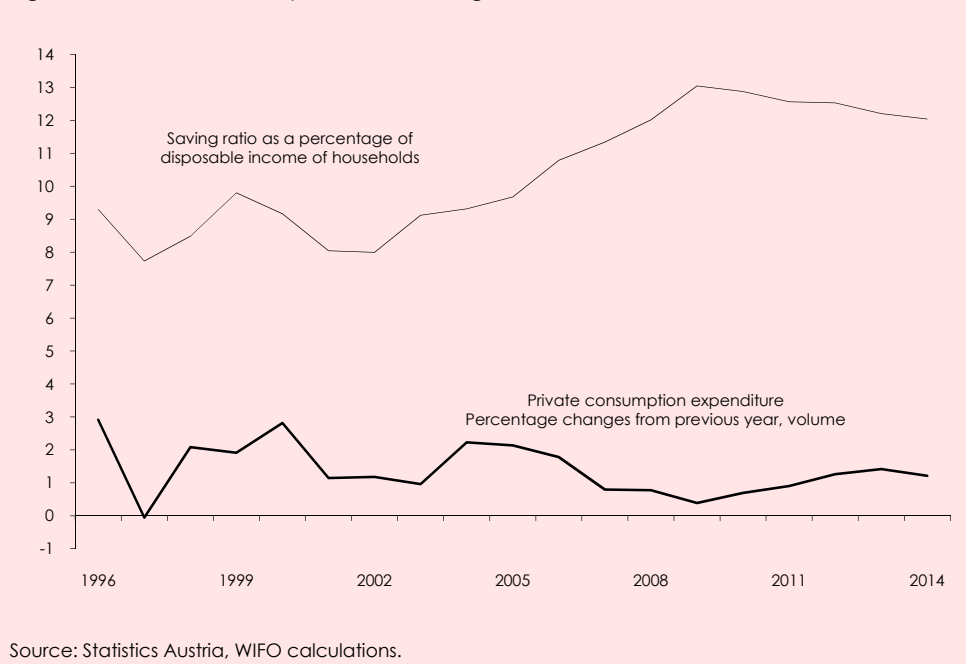


Source: Statistics Austria, WIFO calculations.

Following the price decline from mid-2008 until the first quarter of 2009, the trend in international commodity markets reversed. In the coming years, too, the price of crude oil and other commodities will surge. The forecast assumes that the oil price will rise from \$ 60 per barrel in 2009 to \$ 100 per barrel in 2014 as the world economy recovers. Domestic factors will hardly exert any inflationary pressures in the coming years. During 2010 to 2014 the average inflation rate in Austria is expected to amount to 1½ percent.

The economic recovery assumed in this forecast essentially depends on the cyclical improvement of the global economy. Should the latter not materialise as expected, this would also impair the revival of the Austrian economy. At the same time the stabilisation of the financial markets and the banking system remains fragile. In this context the extensive business activities of Austrian banks in Central, Eastern Europe and Southern Europe entail still substantial risks.

Figure 2: Private consumption and saving ratio



In 2004 to 2008 real GDP grew much faster in Austria than in the euro area (+ $\frac{3}{4}$ percentage point), and also in the recession year 2009 Austrian economic activity shrank by less (+ $\frac{1}{2}$ percentage point). This growth advantage is likely to diminish in the coming years for several reasons:

- Whereas in the most recent years the Austrian economy greatly benefited from trade, exports will slow due to the deterioration of the international business. The Austrian companies which are well-established in the formerly fast-growing economies of the new EU countries in Central and Eastern Europe as well as the accession candidates in Southern Europe (FIW, 2009), will be more strongly affected by the merely weak recovery of this region. In these countries, the boom of the past years was based on high private debt and significant international capital inflows. This trend has come to an end or will slow down substantially. The economic slump in the region will have a lasting effect on Austrian banks, which have a leading market position in Central and Eastern Europe as well as Southern Europe. The increased need for provisions and the unavoidable strengthening of their equity base will also be felt in their domestic business.
- The strength of the German economy rested on the automobile and capital goods industries. These industries were hit hardest by the recession. Substantial global excess capacities will lead to a market clearing, which will also affect Austrian suppliers.

However, several factors suggest that a certain – albeit small – growth advantage of Austria will remain (+ $\frac{1}{4}$ percentage point):

- With respect to unit labour costs Austria's price competitiveness has substantially increased during the last 10 years (Guger – Leoni, 2007, Hölzl – Leoni – Zulehner, 2009). This trend is likely to persist and have a positive medium-term effect on the export industry.
- In some countries of the euro area (particularly Spain, Ireland and France) a house price boom spurred economic growth until mid-2007. The subsequent house price crash implied substantial losses of wealth. In the coming years this will dampen consumption and residential construction (Walterskirchen, 2009).
- The increase of expenditure on research and development in recent years is expected to have a positive effect on the economy in the medium term.

Growth differential vis-à-vis the euro area average shrinks

- The efforts of education policy will equally support the Austrian economy in the coming years – this applies particularly to the upgrading of the universities of applied sciences and the programmes for apprentices and training.
- The Austrian budget deficit is roughly 1 percentage point of GDP below the euro area average (*European Commission, 2009B*). Assuming that all EU countries follow the recommendations of the European Commission (*European Commission, 2009C*) this leads to a lower consolidation requirement for Austria implying potentially smaller adverse demand effects.

Up to 2011 this medium-term forecast for the Austrian economy is based on WIFO's short term forecast of December 2009 (*Marterbauer, 2010*, in this issue). The medium-term forecast was generated with the WIFO's macroeconomic model (*Baumgartner – Breuss – Kaniowski, 2005*). The forecast relies on the assumptions for the international economy in *Schulmeister (2010, in this issue)*, which are briefly summarized below.

In 2010 and 2011, the global economy will regain momentum and the recession will gradually be overcome. On average for the forecast period 2010 to 2014, economic growth in the USA and the euro area will be 2¼ percent and 1½ percent per year, respectively. Economic growth will thus remain substantially below the trend of the decade before the crisis, during which it was ½ percentage point higher than in the forecast period.

Sluggish medium-term growth due to slow global recovery

Table 2: International fundamentals

	Ø 1998-2008	Ø 2003-2008	Ø 1999-2004	Ø 2004-2009	Ø 2009-2014
	Year-to-year percentage changes				
Gross domestic product, volume					
Euro area	+ 2.1	+ 2.1	+ 1.9	+ 0.8	+ 1.6
23 OECD-countries ¹	+ 2.2	+ 2.2	+ 2.3	+ 0.9	+ 2.0
	Ø 1999-2008	Ø 2004-2008	Ø 2000-2004	Ø 2005-2009	Ø 2010-2014
	Dollar per ECU or Euro				
Exchange rate	1.15	1.32	1.03	1.35	1.57
	Dollar per barrel				
Oil price, Brent	45.2	65.5	29.0	69.8	88.8

Source: EU, OECD, WIFO calculations. - ¹ EU 15 (excluding Austria), Iceland, Norway, Switzerland, Turkey, Australia, Japan, Canada, New Zealand, USA.

Due to its close business ties, the Austrian economy is particularly affected by the significant slow-down of growth in the new EU countries. During the next five years, the average GDP growth in the region is expected to amount to 3 percent per year and thus remain 2¼ percentage points below the level of the five years preceding the crisis.

In the wake of the global financial and economic crisis the Austrian economy faced the worst recession since the 1930s. Due to the high degree of international integration, the cyclical recovery in Austria is largely determined by the international developments. Since real exports are expected to increase by 5½ percent per year in the years 2010 to 2014, while real imports will grow slightly less dynamic by 5 percent, the Austrian economy will continue to experience positive but lower net exports. This development follows from weaker demand in Central and Eastern Europe and Germany.

Due to a substantial excess capacity, investment into machinery and equipment will continue to decline in 2010. With the expansion of exports of manufacturing goods, private investment is expected to recover gradually from 2011 onwards. Nevertheless their growth will remain sluggish even in the medium term. The construction industry will not be able to return to the growth rates of the five-year-period preceding the crisis, when especially civil engineering expanded strongly. Although investment projects of quasi-public enterprises such as the federal real estate corporation

During the years 2010 to 2014 the aftermath of the economic crisis will have a particularly strong negative effect on private investment and the growth of Austrian exports. Private consumption, too, will expand more slowly than in the five years before the crisis.

(Bundesimmobiliengesellschaft, BIG), the motorway financing and operating corporation (Autobahnen- und Schnellstraßen-Finanzierungs-Aktiengesellschaft, ASFINAG) and the railway company (Österreichische Bundesbahnen, ÖBB), which were announced for 2009 in the first stimulus package, are expected to materialise in 2010 and thus support construction activity, they will not be sufficient to offset the decline in private residential construction. Construction investment will not reach growth rates of about 2 percent until 2013-2014.

Figure 3: Expenditure on GDP and income

As a percentage of GDP, at current prices



Source: Statistics Austria, WIFO calculations.

Table 3: Components of aggregate demand, volume

	Ø 1998-2008	Ø 2003-2008	Ø 1999-2004	Ø 2004-2009	Ø 2009-2014	2009	2010	2011	2012	2013	2014
	Year-to-year percentage changes										
Consumption expenditure											
Private households ¹	+ 1.6	+ 1.5	+ 1.7	+ 1.2	+ 1.1	+ 0.4	+ 0.7	+ 0.9	+ 1.3	+ 1.4	+ 1.2
General government	+ 1.5	+ 2.0	+ 0.5	+ 2.0	+ 0.5	+ 0.8	+ 1.0	+ 0.5	+ 0.4	+ 0.2	+ 0.5
Gross fixed capital formation	+ 1.4	+ 1.8	+ 0.9	+ 0.1	+ 2.0	- 7.6	- 1.0	+ 2.0	+ 2.5	+ 3.1	+ 3.3
Machinery and equipment ²	+ 2.2	+ 1.9	+ 2.0	- 0.6	+ 3.3	- 12.0	- 1.0	+ 4.0	+ 4.5	+ 4.6	+ 4.7
Construction	+ 0.6	+ 1.7	- 0.1	+ 0.5	+ 0.9	- 4.0	- 1.0	+ 0.5	+ 1.0	+ 1.8	+ 2.1
Domestic demand	+ 1.6	+ 1.9	+ 1.3	+ 1.2	+ 1.3	- 1.4	+ 0.8	+ 1.1	+ 1.4	+ 1.6	+ 1.5
Exports	+ 6.5	+ 7.0	+ 6.9	+ 2.0	+ 5.6	- 13.4	+ 4.0	+ 5.0	+ 6.6	+ 6.5	+ 6.0
Imports	+ 5.3	+ 5.6	+ 6.0	+ 1.2	+ 5.0	- 10.9	+ 2.8	+ 4.3	+ 5.9	+ 6.2	+ 5.8
Gross domestic product	+ 2.4	+ 2.8	+ 1.8	+ 1.6	+ 1.8	- 3.4	+ 1.5	+ 1.6	+ 2.0	+ 2.0	+ 1.9

Source: Statistics Austria, WIFO calculations. – ¹ Including private non-profit institutions serving households. – ² Including other products.

In 2009 and 2010, private consumption is stimulated by the tax reform and the increase of public transfers. Private consumption expenditure will expand by 1 percent per year in the period from 2010 until 2014 and thus remain below the trend of 2004 to 2008. The forecast assumes that the savings ratio, which had increased by 5 percentage points to 13 percent between 2002 and 2009, will decline by 1 percentage point until the end of the forecast period.

In the aftermath of the recession, economic growth in Austria will not even reach the average growth rate of the last 10 years (2½ percent) in the upswing of 2012 to 2014.

Austria's budget deficit will remain above the Maastricht limit of 3 percent of GDP at least until 2013. Projected economic growth is too weak to bring about a consolidation of the government budget exclusively through the automatic stabilisers. Discretionary consolidation measures – mainly on the expenditure side (*Pitlik – Schratzenstaller, 2009*) – from 2011 onwards would be necessary to reduce the budget deficit below 3 percent of GDP.

Economic policy cushioned the consequences of the financial and economic crisis for the real economy by means of a timely discretionary intervention. The measures included a tax reduction, two economic stimulus and two labour market packages of the federal government, measures of the states and local governments as well as by allowing the automatic stabilisers both on the expenditure and on the revenue side to operate. After the budget balance of the government had already been negative (-0.4 percent of GDP) in 2008 despite the favourable economic situation, it worsened to -4.2 percent of GDP and will deteriorate further to -5.2 percent of GDP in 2010. In the coming years, the budget dynamics will be dominated by the consequences of the crisis. During the forecast period 2010 to 2014 the average budget deficit will amount to 4 percent of GDP. Gross government debt will rise from slightly below 60 percent of GDP (in 2007) to almost 80 percent of GDP. Interest payments of the government will increase from 2½ percent of GDP (in 2008) to 3½ percent of GDP and thus substantially limit future room for fiscal policy. Debt of the outsourced quasi-public enterprises ASFINAG, BIG and ÖBB of € 32 billion in 2010 (11 percent of GDP) is not included in these figures.

Compared to 2008 current revenues dropped by 3.4 percent in 2009. In 2010 a further decline by 0.2 percent is to be expected. This development reflects cyclical revenue losses for income tax, value added tax and, particularly, for corporate income tax in 2009 and 2010. The income tax cut, which was brought forward by one year and will incur additional revenue losses of about € 2.1 billion in 2009 and € 2.9 billion in 2010. A stronger growth of government revenues cannot be expected until 2011, as the recovery sets in. Under favourable conditions it will reach 2.7 percent per year throughout the forecast period.

Tax reform and stimulus packages raise budget deficit

Due to the recession and the measures to counter it the general government deficit is expected to increase to 5¼ percent of GDP in 2010. The economic recovery will not be sufficient to reduce the deficit ratio below the 3 percent limit in the forecast period – additional consolidation efforts will be required.

A medium-term reduction of government deficits in line with the Maastricht-Treaty is assumed. In December 2009 the Ecofin Council advised the member countries to reduce their excessive deficits. For Austria the recommendation is to reach a deficit ratio below 3 percent of GDP in 2013 (*European Commission, 2009C, 2009D*). To meet this objective significant consolidation efforts are required. After the substantial expenditure surge in 2009 (+4.1 percent compared to 2008) the annual increase of current expenditures is assumed at only about 2 percent to ensure that budget targets are met. The government expenditure ratio will be well above 50 percent in 2009 and in 2010 and will not drop below the 50 percent mark before 2013.

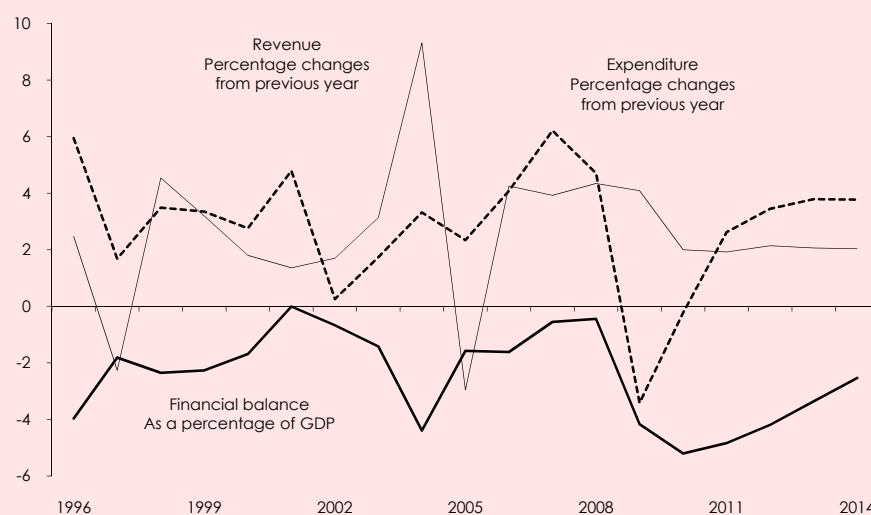
Table 4: General government

Current prices

	Ø 1998-2008	Ø 2003-2008	Ø 1999-2004	Ø 2004-2009	Ø 2009-2014	2009	2010	2011	2012	2013	2014
	Year-to-year percentage changes										
Current revenue	+ 3.3	+ 4.1	+ 2.6	+ 2.7	+ 2.7	- 3.4	- 0.2	+ 2.6	+ 3.5	+ 3.8	+ 3.8
Current expenditure	+ 3.0	+ 3.7	+ 3.4	+ 2.7	+ 2.0	+ 4.1	+ 2.0	+ 1.9	+ 2.1	+ 2.1	+ 2.0
Gross domestic product	+ 4.0	+ 4.8	+ 3.3	+ 3.6	+ 3.1	- 1.7	+ 2.1	+ 2.9	+ 3.4	+ 3.6	+ 3.5
	Ø 1999-2008	Ø 2004-2008	Ø 2000-2004	Ø 2005-2009	Ø 2010-2014	2009	2010	2011	2012	2013	2014
	As a percentage of GDP										
General government financial balance (Maastricht definition)	- 1.5	- 1.7	- 1.6	- 1.7	- 4.0	- 4.2	- 5.2	- 4.8	- 4.2	- 3.4	- 2.5

Source: Statistics Austria, WIFO calculations.

Figure 4: Revenue, expenditure and financial balance (according to Maastricht) of general government



Source: Statistics Austria, WIFO calculations.

Such a rather moderate expenditure growth is favoured by the gradual improvement of the cyclical situation. If the government is to avoid tax increases to consolidate the budget, this requires a determined examination of all expenditure areas and all levels of the public administration in search of efficiency reserves and potential economies, because expenditure growth must be curbed to balance the budget, which has regularly been in deficit for 35 years. The first round of the federal budget law reform, which came into effect at the beginning of 2009 and which de-

finances binding limits for the expenditures in the federal budget via the federal financial framework law, is therefore put to a serious test.

The short-term growth effects of a budget consolidation are ambiguous. On the one hand spending cuts (or tax hikes) dampen aggregate demand ("Keynesian effects"), on the other hand consolidation efforts can raise demand via expectation effects ("non-Keynesian effects"). The empirical literature shows that the net effect depends on a large number of factors such as domestic and international economic activity, the level of government debt, the real interest rate, the policy approach to budget consolidation (revenue-based or expenditure-based) as well as the policy mix and the credibility of monetary and fiscal policies (e.g., McDermott – Wescott, 1996, von Hagen – Strauch, 2001, Prammer, 2004, Canale et al., 2007, Alesina – Ardagna, 2009).

The general uncertainty of the economic outlook, and the fact that despite the existence of a budget framework for the federal government, no concrete draft budget has been passed yet for 2011 and the following years make the current budget forecast particularly uncertain. Further uncertainty result from the expenditure habits of the federal states and the local governments, for which only scarce and incomplete information is available.

During the upswing from 2003 until 2008 the number of employees increased strongly (+1.6 percent per year) and full-time employment expanded significantly. In addition, the relatively low share of part time employment rose above the EU average. The employment is expected to decline by 1.7 percent until 2010.

No improvement in the labour market

Table 5: Labour market, income

	Ø 1998-2008 ¹	Ø 2003-2008 ¹	Ø 1999-2004 ¹	Ø 2004-2009 ¹	Ø 2009-2014 ¹	2009	2010	2011	2012	2013	2014
	Year-to-year percentage changes										
Persons in active employment ²	+ 1.0	+ 1.6	+ 0.3	+ 1.2	+ 0.4	- 1.3	- 0.3	+ 0.3	+ 0.6	+ 0.7	+ 0.7
Registered unemployed	- 1.1	- 2.4	+ 1.9	+ 1.3	+ 3.2	+ 22.4	+ 7.7	+ 6.1	+ 2.1	+ 0.0	+ 0.4
Unemployment rate											
Eurostat definition ³	in percent	4.3	4.6	4.1	4.6	5.6	5.0	5.4	5.7	5.7	5.6
National definition ⁴	in percent	6.6	6.6	6.6	6.7	8.1	7.1	7.7	8.1	8.2	8.2
Productivity ⁵	+ 1.3	+ 1.4	+ 1.3	+ 0.5	+ 1.2	- 2.4	+ 1.4	+ 1.1	+ 1.2	+ 1.1	+ 1.0
Gross wages and salaries ⁶	+ 3.5	+ 4.3	+ 2.4	+ 4.1	+ 2.7	+ 1.4	+ 1.1	+ 2.4	+ 3.2	+ 3.4	+ 3.5
Per employee ⁷	+ 2.3	+ 2.6	+ 2.0	+ 2.7	+ 2.1	+ 2.3	+ 1.2	+ 1.9	+ 2.4	+ 2.5	+ 2.6
Unit labour costs, total economy	+ 0.9	+ 1.1	+ 0.5	+ 2.3	+ 0.9	+ 5.2	- 0.2	+ 0.8	+ 1.1	+ 1.4	+ 1.5

Source: Federation of Austrian Social Security Institutions, Statistics Austria, WIFO calculations. – ¹ Unemployment rate: Ø 1999-2008, Ø 2004-2008, Ø 2000-2004, Ø 2005-2009, Ø 2010-2014. – ² Excluding parental leave, military service, and unemployed persons in training. – ³ According to Eurostat Labour Force Survey, percent of total labour force. – ⁴ According to Public Employment Service, percent of total labour force excluding self-employed. – ⁵ Real GDP per employment (dependent and self-employed according to National Accounts definition). – ⁶ Excluding employers' contributions. – ⁷ Employees according to National Accounts definition.

The expected average real GDP growth of 1.8 percent will lead to an expansion of employment by 0.7 percent per year from 2012 onwards. Full-time employment will not increase before the end of the forecast period.

The sluggish growth will not be sufficient to prevent an increase of the unemployment rate, especially since the supply of domestic and foreign workers grows significantly. According to this forecast the number of unemployed persons will rise to just below 305,000 by 2014 (+92,000 compared to 2008).

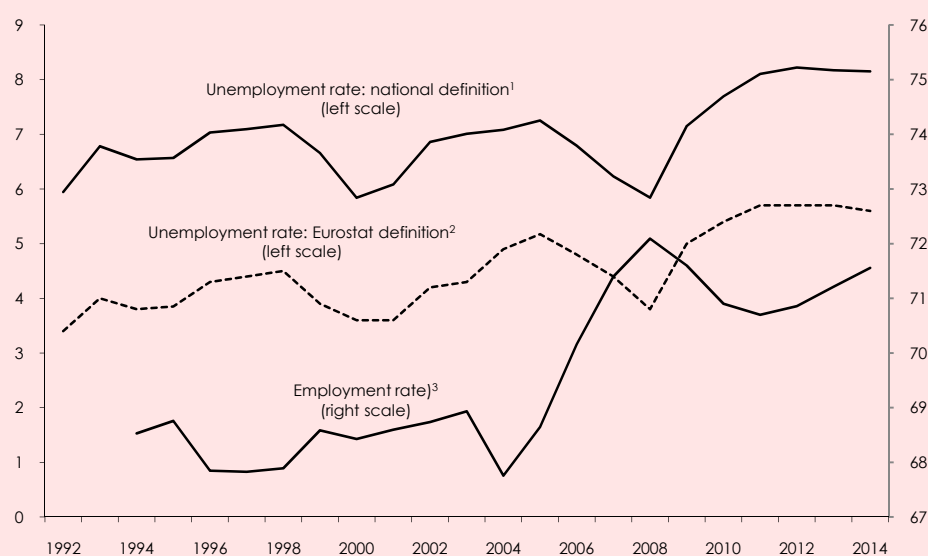
For the average of the period 2010 to 2014 we expect an unemployment rate of 8.1 percent of the labour force excluding self-employed persons according to the national definition or 5.6 percent of the total labour force according to the Eurostat definition. The unemployment will not recede even by the end of the forecast period. Although the labour market situation in Austria seems favourable by international comparison, the fight against unemployment will be the dominating economic and social policy issue of the coming years besides the consolidation of pub-

In the coming years unemployment will remain a key concern for economic and social policy. The unemployment rate (according to the definition of the Public Employment Service, AMS) will average at 8.1 percent in 2010-2014, with more than 300,000 persons out of work in 2014.

lic finances. Coping with this potential conflict of policy objectives is becoming the key challenge for economic policymakers.

From 2011 onwards workers from the new EU countries (excluding Romania and Bulgaria) will enjoy full labour mobility. Already in 2009 labour market access was liberalised for qualified workers from the new EU countries. So far administrative limitations have kept the official inflow of workers from this region at a moderate level. The actual scale of worker migration from the new EU countries will strongly depend on the employment opportunities and thus on the economic developments in Austria (especially in tourism and construction). The wage differentials between Austria and the new EU countries remain sufficient to make Austrian jobs attractive. Recently wage differentials further increased by the devaluations in Hungary and other countries of Central and Eastern Europe.

Figure 5: Labour market trends



Source: Public Employment Service, WIFO calculations. – ¹ As a percentage of total labour force exclusive self-employed; according to Public Employment Service. – ² As a percentage of total labour force; according to Eurostat Labour Force Survey. – ³ Persons in employment as a percentage of population of working age (15 to 64).

Recent fluctuations of the inflation rate were strongly influenced by the evolution of international crude oil and commodity prices. Both the increase of the inflation rate (as measured by the consumer price index) to almost 4 percent in 2008 and the decline to –0.3 percent in July 2009 were mainly due to fluctuations in oil prices. Measured by the core inflation rate, price trends were much more stable (e.g., Baumgartner, 2009).

Inflation remains moderate

Table 6: Implicit price indices

	Ø 1998-2008	Ø 2003-2008	Ø 1999-2004	Ø 2004-2009	Ø 2009-2014	2009	2010	2011	2012	2013	2014
	Year-to-year percentage changes										
Private consumption	+ 1.9	+ 2.4	+ 1.7	+ 2.1	+ 1.6	+ 0.5	+ 1.3	+ 1.5	+ 1.7	+ 1.9	+ 1.8
Exports	+ 1.2	+ 1.9	+ 0.6	+ 1.2	+ 1.2	– 2.4	+ 1.1	+ 0.6	+ 1.6	+ 1.6	+ 1.3
Imports	+ 1.6	+ 2.7	+ 0.6	+ 1.6	+ 1.8	– 4.4	+ 2.1	+ 0.7	+ 2.2	+ 2.2	+ 1.9
Gross domestic product	+ 1.5	+ 1.9	+ 1.4	+ 1.9	+ 1.3	+ 1.8	+ 0.7	+ 1.3	+ 1.4	+ 1.6	+ 1.6

Source: Statistics Austria, WIFO calculations.

The forecast assumes that the oil price will increase from \$ 60 per barrel in 2009 to \$ 100 in 2014 (Schulmeister, 2010). Inflation slowed down considerably in 2009 (+½ percent), as the international quotations of agricultural products and crude oil

declined. In the coming years prices will rise slightly faster, so that an average inflation rate of 1½ percent is expected for the years 2010 to 2014. Inflation will thus be more than ½ percentage point below the average of 2004 to 2008.

In addition to the evolution of energy and commodity quotations, inflation trends are determined by the dynamics of unit labour cost, the burden of indirect taxes and fees as well as competition policy. These factors will not exert any inflationary pressures in the near future either.

Wages will react to the low inflation and the labour market situation. In the forecast period from 2010 until 2014 an average per-capita increase of nominal wages of 2 percent per year can be expected. At 1 percent unit labour costs of the whole economy – the most important determinant of domestic cost pressure – will rise by ¼ percentage point more slowly than in the five years before the crisis. Real per capita wages are expected to increase only half as fast as labour productivity in 2010 to 2014.

This medium-term forecast for Austria rests on the assumption that the global real economy will steadily – though slowly – overcome the consequences of the financial crisis and no new pronounced cyclical setback will occur. Should the world economy not improve as assumed (e.g., because of a massive appreciation of the euro vis-à-vis the dollar or a strong surge in commodity prices), the recovery of the Austrian economy would also be impaired. Furthermore, the financial markets and the banking system remain fragile. The extensive involvement of Austrian banks in Central and Eastern Europe as well as Southern Europe still entail substantial risks.

Risks and uncertainties

Alesina, A., Ardagna, S., "Large Changes in Fiscal Policy: Taxes Versus Spending", NBER Working Paper, 2009, (15348).

Baumgartner, J., "Die Auswirkungen der Finanzmarkt- und Wirtschaftskrise auf die Inflation", WIFO-Monatsberichte, 2009, 82(12), pp. 955-960, http://www.wifo.ac.at/www/jsp/index.jsp?fid=23923&id=37847&typeid=8&display_mode=2.

Baumgartner, J., Breuss, F., Kaniowski, S., "WIFO-Macromod – An Econometric Model of the Austrian Economy", in OeNB (Editor), "Macroeconomic Models and Forecasts for Austria", Proceedings of OeNB Workshops, 2005, (5), pp. 61-86.

Breuss, F., Kaniowski, S., Schratzenstaller, M., "Macro-economic Effects Of the Fiscal Stimulus Measures in Austria", Austrian Economic Quarterly, 2009, 14(4), pp. 205-2186, http://www.wifo.ac.at/www/jsp/index.jsp?fid=23923&id=37561&typeid=8&display_mode=2.

Canale, R.R., Foresti, P., Marani, U., Napolitano, O., "On Keynesian Effects of (Apparent) Non-Keynesian Fiscal Policies", MPRA Paper, 2007, (3742), <http://mpra.ub.uni-muenchen.de/3742/>.

European Commission (2009A), "Impact of the Current Economic and Financial Crisis on Potential Output", European Economy, Occasional Paper, 2009, (49).

European Commission (2009B), "European Economic Forecast – Autumn 2009", European Economy, 2009, (10), http://ec.europa.eu/economy_finance/publications/publication16055_en.pdf.

European Commission (2009C), Excessive Deficit Procedure Steps: The Stability and Growth Pact as the Anchor for Fiscal Exit Strategies, Press release IP/09/1694, 11 November 2009, <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/1694>.

European Commission (2009D), Austria – Commission Assessment in Relation to the Commission Recommendation for a Council Decision and Recommendation under Articles 104.6 and 104.7 of the Treaty, Brussels, 2009, http://ec.europa.eu/economy_finance/publications/publication16188_en.pdf.

FIW, Österreichs Außenwirtschaft 2009, WIFO and wiiw, Vienna, 2009.

Gaggl, P., Janger, J., "Wird die aktuelle Rezession nachhaltige Auswirkungen auf das Produktionspotenzial in Österreich haben?", Geldpolitik und Wirtschaft, 2009, (Q3), pp. 27-57, http://www.oenb.at/de/img/qewi_2009_q3_analyse02_tcm14-142507.pdf.

Guger, A., Leoni, Th., "International Unit Labour Cost Position Improved in 2006", Austrian Economic Quarterly, 2007, (12)4, pp. 189-198, http://www.wifo.ac.at/www/jsp/index.jsp?fid=23923&id=30980&typeid=8&display_mode=2.

Hözl, W., Leoni, Th., Zulehner, Ch., "International unit Labour Cost Position Slightly Improved in 2008, Austrian Economic Quarterly, 2008, (13)4, pp. 193-204, http://www.wifo.ac.at/www/jsp/index.jsp?fid=23923&id=37303&typeid=8&display_mode=2.

IMF (2009A), World Economic Outlook, April 2009. Chapter 3: From Recession to Recovery. How Soon and How Strong, Washington D.C., 2009, pp. 103-138, <http://www.imf.org/external/pubs/ft/weo/2009/01/pdf/c3.pdf>.

IMF (2009B), World Economic Outlook, October 2009. Chapter 4: What's the Damage? Medium-term Output Dynamics after Financial Crisis, Washington D.C., 2009, pp. 121-151, <http://www.imf.org/external/pubs/ft/weo/2009/02/pdf/c4.pdf>.

References

- Mahringer, H., "Der Arbeitsmarkt in der Finanzmarkt- und Wirtschaftskrise", WIFO-Monatsberichte, 2009, 82(12), pp. 967-978, http://www.wifo.ac.at/www/jsp/index.jsp?fid=23923&id=37862&typeid=8&display_mode=2.
- Marterbauer, M., Cyclical Stabilisation, But No Robust Upturn. Economic Outlook for 2010 and 2011, Austrian Economic Quarterly, 2010, 15(1), pp. 1-12, http://www.wifo.ac.at/www/jsp/index.jsp?fid=23923&id=38181&typeid=8&display_mode=2.
- McDermott, J., Wescott, R. F., "An Empirical Analysis of Fiscal Adjustments", IMF Working Paper, 1996, (59).
- Pitlik, H., Schratzenstaller, M., "Finanzmarktkrise und öffentliche Haushalte", WIFO-Monatsberichte, 2009, 82(12), pp. 961-966, http://www.wifo.ac.at/www/jsp/index.jsp?fid=23923&id=37861&typeid=8&display_mode=2.
- Prammer, D., "Expansionary Fiscal Consolidations? An Appraisal of the Literature on Non-Keynesian Effects of Fiscal Policy and a Case Study for Austria", Monetary Policy & the Economy, 2004, (Q3), pp. 34-52, http://www.oenb.at/en/img/mop_20043_analyses3_tcm16-21309.pdf.
- Schulmeister, St., "Langsame Erholung der weltweiten Wachstumsdynamik. Mittelfristige Prognose der Weltwirtschaft bis 2014", WIFO-Monatsberichte, 2010, 83(1), pp. 37-45, http://www.wifo.ac.at/www/jsp/index.jsp?fid=23923&id=38124&typeid=8&display_mode=2.
- von Hagen, J., Strauch, R., "Fiscal Consolidations: Quality, Economic Conditions, and Success", Public Choice, 2001, 109, pp. 327-346.
- Walterskirchen, E., "Immobilienkrise – mehr als der Auslöser der Finanzmarktkrise", WIFO-Monatsberichte, 2009, 82(12), pp. 943-950, http://www.wifo.ac.at/www/jsp/index.jsp?fid=23923&id=37845&typeid=8&display_mode=2.

Gradual Recovery Following Severe Recession

Medium-Term Projections for the Austrian Economy until 2014 – Summary

At the end of 2008 the international financial and economic crisis triggered the deepest recession since the 1930s. At an annual rate of 1.8 percent the Austrian economy will expand more slowly – by $\frac{3}{4}$ percentage point – than in the 10 years before the economic crisis of 2009. Austria's growth advantage vis-à-vis the average of the euro area is diminishing, not least because exports to Central and Eastern Europe are likely to expand less dynamically.

Economic policy in Austria countered the effects of the international financial and economic crisis through a mix of revenue and expenditure measures. The Austrian economy also benefited from the economic stimulus of its main trade partners. These spill-over effects are estimated to be almost as strong as the measures implemented by the Austrian federal government itself.

In Austria, unlike in most other countries of the euro area, the favourable trend of real disposable household income facilitated an increase of private final consumption expenditure in 2009. However, a larger share of the income increase than in past years was saved. For the forecast period 2010-2014 consumption is expected to grow by 1 percent annually, which is almost $\frac{1}{2}$ percentage point below the average growth rate of the five years before the crisis. This forecast rests on the assumption that the household savings ratio will decline again.

The revival of global trade will lead to an increase of the Austrian exports by an average of $5\frac{1}{2}$ percent per year, almost 1 percentage point less than in the ten years before the crisis. Due to the very low capacity utilisation the recovery of export demand will not be sufficient to induce a recovery of investment activity. During the whole forecast period investment is expected to increase by an average of 2 percent per year.

As a consequence of the recession unemployment reached the highest level since the mid-1950s in 2009. Although the extension of short-time working schemes, training and educational leave slowed the increase in the number of unemployed persons by about 13,000 in 2009, unemployment will remain a key economic policy challenge in the coming years. The number of registered unemployed persons is expected to rise by slightly more than 90,000 between 2008 and 2014 to more than 300,000. During the period from 2010 until 2014 the unemployment rate (as defined by the Public Employment Service, AMS) is expected to amount to 8.1 percent on average. At the same time employment will rise by 0.4 percent per year. However, full-time employment is not expected to expand substantially before the end of the forecast period.

The decline of government revenues due to the crisis and the tax reform as well as the increase of government spending in the wake of the recession will raise the general government deficit to $5\frac{1}{4}$ percent of GDP in 2010. Despite the budget improvement induced by the economic recovery, measures to consolidate the budget will have to be taken, if the deficit ratio is to be reduced below 3 percent of GDP by 2014.

The economic recovery assumed in this forecast crucially depends on a revival of the world economy. If the latter does not materialise as expected, the recovery of the Austrian economy will be impaired. In addition, Austrian banks' extensive business activities in Central Eastern and Southern Europe still entail substantial risks.