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A-1103 WIEN, POSTFACH 91
TEL. 798 26 01 • FAX 798 93 86

 **ÖSTERREICHISCHES INSTITUT FÜR
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**BUSINESS CYCLE RECOVERY
DELAYED**

**ECONOMIC OUTLOOK FOR 2002
AND 2003**

September 2002

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Austrian Institute of Economic Research

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ECONOMIC OUTLOOK FOR 2002 AND 2003

EWALD WALTERSKIRCHEN

The Austrian economy is set to grow by slightly less than 1 percent this year and by over 2 percent in 2003. The risks surrounding the recovery of the business cycle, to which WIFO had pointed in its forecast of last June, have materialised. The slide in stock market values has undermined consumer and business confidence world-wide. Given the degree of uncertainty and the weaker sentiment, growth prospects have to be revised downwards. Sluggish activity is being reflected in a marked rise in unemployment and in budget deficits exceeding initial targets.

Since last July, the business outlook for the USA and for Europe has deteriorated¹⁾. The sharp fall on stock markets has negative repercussions also on the real economy via financial wealth losses and growing market pessimism. According to business survey results and forward-looking indicators, demand and output will move at a slower pace than expected. Projections for Europe are more in need of correction than those for the USA, given the particularly disappointing recent performance of the EU economy. This has implications not only for Austrian export prospects, but also for companies' investment plans.

Until mid-year, the recovery in Austria proceeded as expected. Real GDP gained about ½ percent from quarter to quarter. Then, in summer, business confidence weakened. Expectations for the coming months were revised, reflecting doubts about the robustness of activity in the USA as well as the slump on stock markets. Not yet included in the survey results were the consequences of the floods; the associated shortfalls in production came as an additional negative, albeit short-lived, factor.

¹⁾ See Kramer, H., Budgetpolitik und wirtschaftspolitische Strategie, WIFO, Vienna, August 2002, http://titan.wsr.ac.at/wifosite/wifosite.get_abstract_type?p_language=2&pubid=22581&pub_language=-1&p_type=0.

Because of the delay in the recovery, the WIFO growth projection for 2002 that had been kept unchanged since last December, has to be taken down by $\frac{1}{4}$ percentage point to a rate of 0.9 percent. This has implications also for next year, as the pace of the recovery will be slower than expected so far. GDP growth in 2003 is revised down by $\frac{1}{2}$ percentage point to a rate of 2.2 percent. This scenario assumes that the standstill of the recovery will be overcome and the upward trend will resume next year. It is supported by the argument that confidence in stock-exchange listed companies should gradually return and that the backlog in deferred investment will unwind, if only to meet the need for replacement. The persistent low level of interest rates and the fiscal investment premium offer incentives in this regard.

The recovery nevertheless remains subject to considerable risks. In the USA, business activity still has to pass the test of robustness. A war against Iraq would send oil prices to new hikes and drive stock markets down even further. In the EU, some larger countries are faced with the need to take restrictive fiscal policy action in the current period of sluggishness, in order to comply with the obligations of the Stability and Growth Pact.

In Austria, growth has been supported largely by the foreign contribution. Because of weak domestic demand, notably for investment goods, merchandise imports will fall by 3 percent in volume. The current account deficit will thereby be cut in half.

The sharp fall in investment, with an annual decline of 5 percent now lasting for two years, together with a steep rise in unemployment, has prompted the federal government to present a "package" to stimulate growth and employment. A 10 percent investment premium granted up to the end of 2003 shall encourage firms to carry investment plans forward.

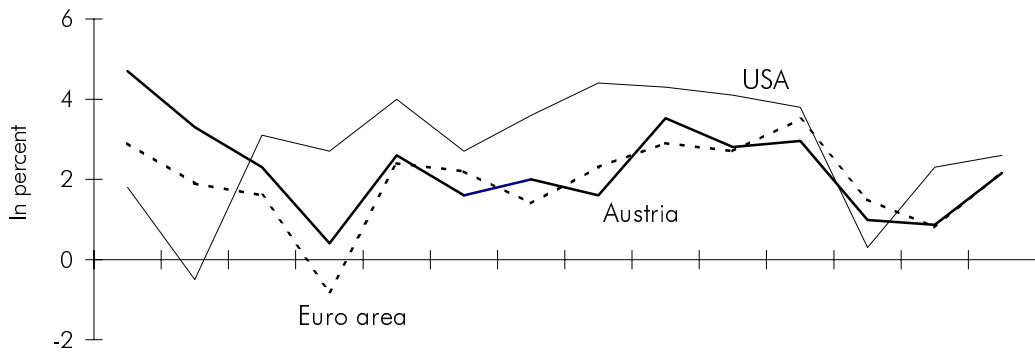
The measures taken so far by the federal and the state governments to stimulate the economy, as well as repair works after the floods, will help sustain construction activity, particularly in civil engineering. The projection for construction output is adjusted from -2 to -1 percent. In 2003, construction output should edge up as renovation of structures damaged by the floods continues. Private consumption, adjusted for inflation, has so far maintained the year-earlier level. However, car purchases and private residential investment have taken a steep fall.

The cyclical weakness has led to shortfalls in tax revenues of about € 2 billion this year. To this should be added the budgetary burden of € 1 billion induced by the flood damages. The general government household for 2002 will thereby exhibit a deficit of around 1½ percent of GDP. Government expenditure (excluding flood aid and unemployment benefits) hardly deviates from budgetary targets. For 2003, the deficit is projected at slightly above 1 percent of GDP, provided the recovery proceeds as expected.

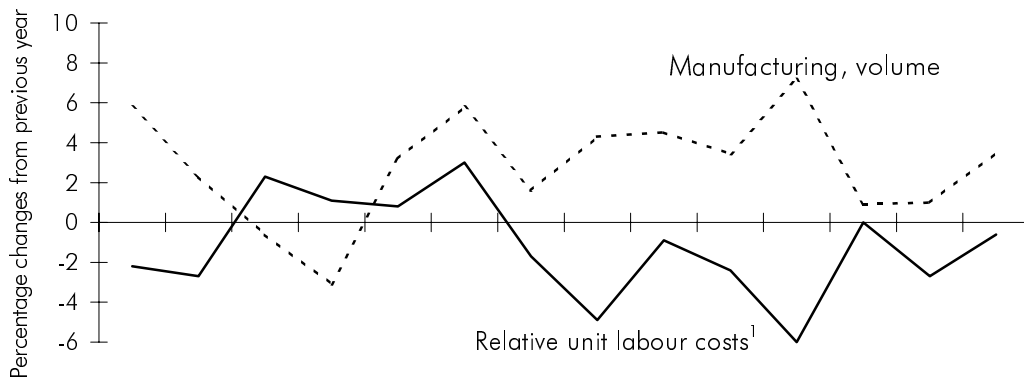
The slowdown of economic growth is causing an unusually sharp increase in unemployment (+31,000), one of the highest among EU countries in 2002. As expected, demand for labour slackened, but at the same time labour supply was boosted by the raise in the early retirement age and by the generous granting of work permits for foreign seasonal workers. The rate of unemployment will therefore go up from 6.1 percent (2001) to 6.9 percent this year, staying at a high level in 2003. The Federal government's cyclical stimulus "package" comes rather late in preventing the deterioration of job opportunities for the young. The measures in the context of the "youth safety net" (Jugendauffangnetz) have been extended, the apprenticeship promotion reinforced.

Overall inflation is projected to decelerate. Consumer prices are set to rise by 1.8 percent on annual average 2002, 1 percentage point less than in 2001 owing to a stabilisation of energy prices. A further decline to a rate of 1.4 percent may be expected for 2003, as the next wage round in the private sector should result in lower settlements than the previous one and a number of irregular factors such as price hikes for seasonal goods, will wear off.

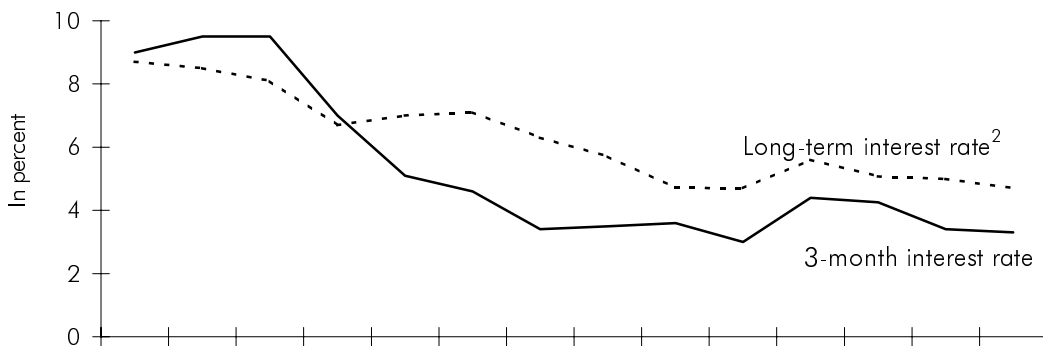
Growth of real GDP



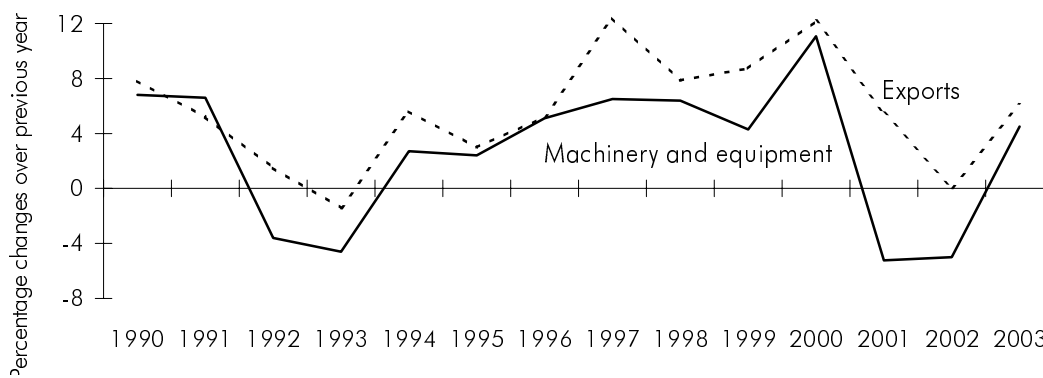
Competitiveness and manufacturing output



Short-term and long-term interest rates



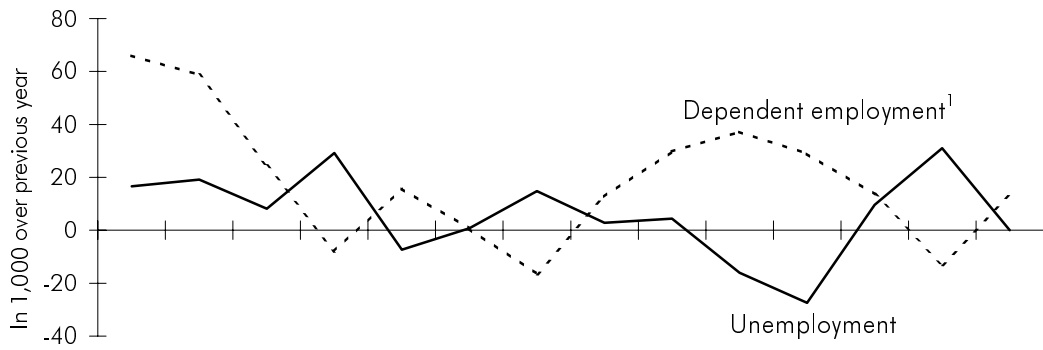
Exports and gross fixed investment (constant prices)



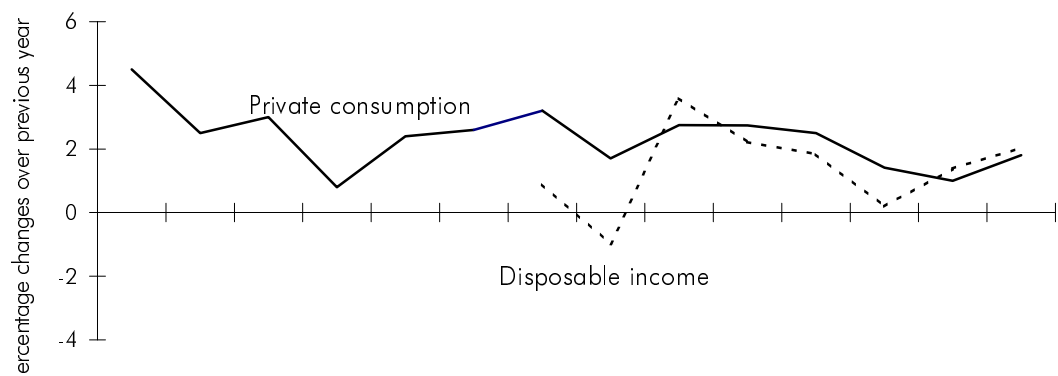
¹ Manufacturing; in a common currency vis-à-vis trading partners.–

² 10-year central government bonds (benchmark).

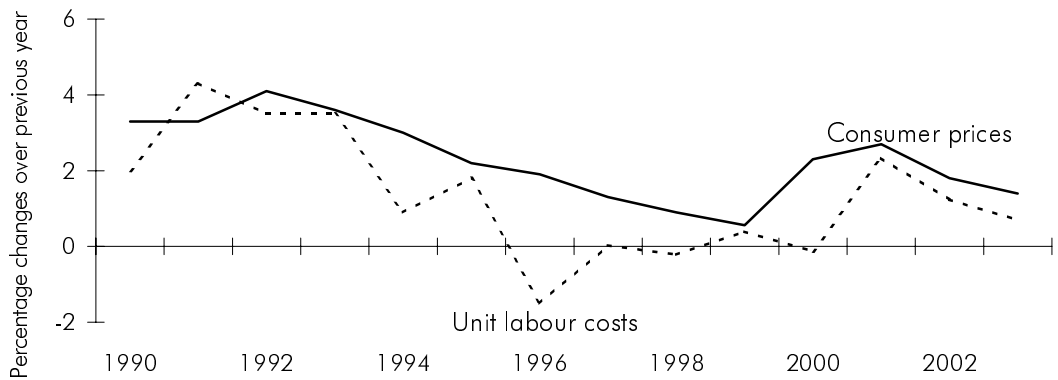
Employment and unemployment



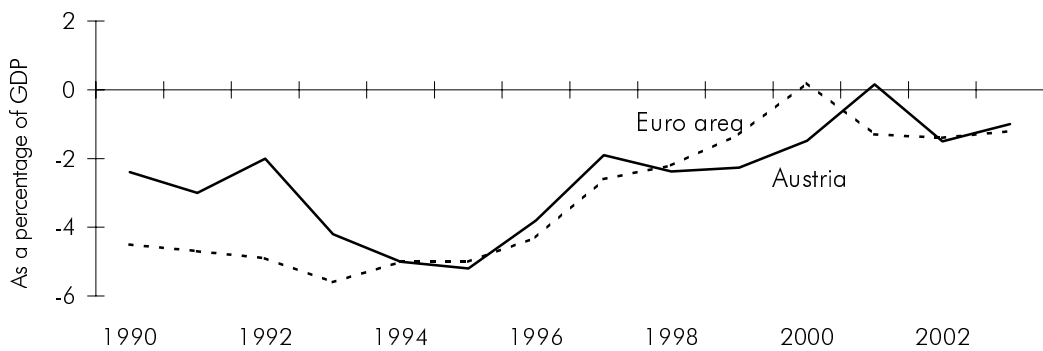
Consumption and income of private households (constant prices)



Inflation and unit labour costs



General government financial balance



¹ Excluding parental leave and military service.

Main results

Percentage changes from previous year

		1998	1999	2000	2001	2002	2003
GDP							
Volume		+ 3,5	+ 2,8	+ 3,0	+ 1,0	+ 0,9	+ 2,2
Value		+ 4,1	+ 3,5	+ 4,2	+ 2,7	+ 2,1	+ 3,6
Manufacturing¹, volume		+ 4,4	+ 3,4	+ 7,3	+ 0,9	+ 1,0	+ 3,5
Private consumption expenditure, volume		+ 2,8	+ 2,7	+ 2,5	+ 1,4	+ 1,0	+ 1,8
Gross fixed investment, volume		+ 3,4	+ 1,5	+ 5,1	- 3,4	- 2,8	+ 2,8
Machinery and equipment ²		+ 6,4	+ 4,3	+ 11,1	- 5,2	- 5,0	+ 4,5
Construction		+ 1,3	- 0,7	+ 0,3	- 1,7	- 1,0	+ 1,5
Exports of goods³							
Volume		+ 8,1	+ 7,7	+ 13,1	+ 5,4	+ 3,0	+ 6,0
Value		+ 8,4	+ 7,0	+ 15,6	+ 6,5	+ 3,2	+ 7,1
Imports of goods³							
Volume		+ 7,1	+ 6,9	+ 10,9	+ 2,8	- 3,0	+ 6,5
Value		+ 6,6	+ 6,7	+ 14,7	+ 5,0	- 2,8	+ 7,6
Current balance	€ bn	- 4,68	- 6,33	- 5,35	- 4,65	- 1,83	- 1,67
As a percentage of GDP	%	- 2,5	- 3,2	- 2,6	- 2,2	- 0,9	- 0,7
Long-term interest rate⁴	%	4,7	4,7	5,6	5,1	5,0	4,7
Consumer prices		+ 0,9	+ 0,6	+ 2,3	+ 2,7	+ 1,8	+ 1,4
Unemployment rate							
Percent of total labour force ⁵	%	4,5	3,9	3,7	3,6	4,1	4,1
Percent of dependent labour force ⁶	%	7,2	6,7	5,8	6,1	6,9	6,9
Dependent employment⁷		+ 1,0	+ 1,2	+ 1,0	+ 0,4	- 0,4	+ 0,4
General government financial balance according to Maastricht definition							
As a percentage of GDP	%	- 2,4	- 2,3	- 1,5	+ 0,2	- 1,5	- 1,0

¹ Value added, including mining and quarrying.- ² Including other products.-

³ According to Statistics Austria.- ⁴ 10-year central government bonds (benchmark).-

⁵ According to Eurostat.- ⁶ According to Labour Market Service.- ⁷ Excluding parental leave and military service.

Key policy indicators

	1998	1999	2000	2001	2002	2003
Fiscal policy						
	As a percentage of GDP					
General government financial balance						
according to Maastricht definition	- 2,4	- 2,3	- 1,5	+ 0,2	- 1,5	- 1,0
according to National accounts	- 2,5	- 2,4	- 1,7	+ 0,0	- 1,7	- 1,2
General government primary balance	+ 1,4	+ 1,4	+ 2,3	+ 3,9	+ 1,9	+ 2,3
Monetary policy						
	In percent					
3-month interest rate	3,6	3,0	4,4	4,3	3,4	3,3
Long-term interest rate ¹	4,7	4,7	5,6	5,1	5,0	4,7
	Percentage changes from previous year					
Effective exchange rate						
Nominal	+ 2,8	+ 1,5	- 2,5	+ 1,0	+ 0,4	+ 0,9
Real	+ 0,3	- 1,1	- 3,6	+ 0,1	- 0,2	± 0,0

¹ 10-year central government bonds (benchmark).

World economy

Percentage changes from previous year

	1998	1999	2000	2001	2002	2003	
Real GDP							
Total OECD	+ 2,8	+ 3,2	+ 3,8	+ 0,8	+ 1,3	+ 2,3	
USA	+ 4,3	+ 4,1	+ 3,8	+ 0,3	+ 2,3	+ 2,6	
Japan	- 1,1	+ 0,7	+ 2,4	- 0,2	- 1,0	+ 1,0	
EU	+ 2,9	+ 2,8	+ 3,5	+ 1,6	+ 1,0	+ 2,3	
Euro area	+ 2,9	+ 2,7	+ 3,5	+ 1,5	+ 0,8	+ 2,2	
Germany	+ 2,0	+ 2,0	+ 2,9	+ 0,6	+ 0,5	+ 1,8	
Central Eastern Europe ¹	+ 3,6	+ 3,2	+ 3,9	+ 2,3	+ 1,5	+ 2,8	
World trade, volume	+ 5,6	+ 6,0	+ 12,7	+ 0,3	+ 3,5	+ 7,0	
OECD exports	+ 5,7	+ 5,7	+ 12,0	- 0,8	+ 2,0	+ 7,5	
Intra-OECD trade	+ 8,3	+ 7,8	+ 11,4	- 1,4	+ 1,5	+ 5,5	
Market growth²	+ 11,3	+ 7,4	+ 12,8	+ 2,2	+ 2,0	+ 5,5	
Primary commodity prices, in US\$							
HWWA Index, total, 1990=100	- 22,0	+ 12,0	+ 31,0	- 11,0	+ 2,0	+ 2,0	
Excluding energy	- 13,0	- 8,0	+ 1,0	- 7,0	- 3,0	+ 3,0	
Crude oil prices							
Average import price (cif) for OECD countries	US\$/barrel	12,6	17,3	28,0	23,5	24,5	25,0
Exchange rate							
US\$ per ECU/Euro	1,121	1,067	0,924	0,896	0,94	1,00	

¹ Poland, Slovak Republic, Slovenia, Czech Republic, and Hungary.

² Real import growth of trading partners weighted by Austrian export shares.

WIFO

Projections - September 2002

Private consumption, income and prices

	1998	1999	2000	2001	2002	2003
Percentage changes from previous year, volume						
Private consumption expenditure	+ 2,8	+ 2,7	+ 2,5	+ 1,4	+ 1,0	+ 1,8
Durables	+ 5,8	+ 9,4	+ 3,9	- 2,6	- 2,0	+ 3,5
Non-durables and services	+ 2,3	+ 1,8	+ 2,3	+ 2,0	+ 1,4	+ 1,5
Household disposable income	+ 3,6	+ 2,2	+ 1,8	+ 0,2	+ 1,4	+ 2,0
Household saving ratio						
As a percentage of disposable income	8,0	7,7	6,7	5,5	6,0	6,6
Percentage changes from previous year						
Direct lending to domestic non-banks¹	+ 3,7	+ 5,2	+ 6,7	+ 3,5	+ 1,9	+ 2,4
In percent						
Inflation rate						
National	0,9	0,6	2,3	2,7	1,8	1,4
Harmonised	0,8	0,5	2,0	2,3	1,8	1,4
Core inflation ²	1,2	0,6	0,9	2,2	2,1	1,7

¹ End of period.

² Excluding unprocessed food (meat, fish, fruits, vegetables) and energy items.

Productivity

Percentage changes from previous year

	1998	1999	2000	2001	2002	2003
Total economy						
Real GDP	+ 3,5	+ 2,8	+ 3,0	+ 1,0	+ 0,9	+ 2,2
Employment ¹	+ 0,7	+ 1,2	+ 0,5	+ 0,2	- 0,2	+ 0,6
Full-time equivalent	+ 0,8	+ 1,0	+ 1,3	+ 0,1	- 0,3	+ 0,5
Productivity (GDP per employment)	+ 2,8	+ 1,5	+ 2,5	+ 0,8	+ 1,1	+ 1,5
Full-time equivalent	+ 2,7	+ 1,8	+ 1,6	+ 0,9	+ 1,2	+ 1,6
Manufacturing						
Production ²	+ 4,5	+ 3,4	+ 7,2	+ 0,9	+ 1,0	+ 3,5
Employees ³	+ 0,1	- 0,7	+ 0,0	+ 0,2	- 2,3	- 0,5
Productivity per hour	+ 4,3	+ 4,8	+ 7,3	+ 1,3	+ 4,4	+ 3,9
Working hours per day per employee ⁴	+ 0,1	- 0,6	- 0,1	- 0,6	- 1,0	+ 0,1

¹ Dependent and self-employed according to National Accounts.-

² Value added.-

³ According to Federation of Austrian Social Security Institution.-

⁴ According to 'Konjunkturerhebung' of Statistics Austria.

Earnings and international competitiveness

Percentage changes from previous year

	1998	1999	2000	2001	2002	2003
Gross earnings per employee ¹	+ 3,0	+ 2,0	+ 2,5	+ 3,1	+ 2,2	+ 2,2
Full-time equivalent	+ 3,2	+ 2,4	+ 2,3	+ 3,4	+ 2,4	+ 2,6
Gross real earnings per employee ¹	+ 2,5	+ 1,2	+ 1,0	+ 0,8	+ 0,4	+ 0,8
Net real earnings per employee	+ 2,3	+ 4,3	+ 1,7	+ 0,1	- 0,3	+ 0,2
Net wages and salaries	+ 3,3	+ 3,7	+ 4,3	+ 2,6	+ 2,0	+ 2,4
<i>Total economy</i>						
Unit labor costs	- 0,2	+ 0,4	- 0,1	+ 2,3	+ 1,2	+ 0,7
<i>Manufacturing</i>						
Unit labor costs	- 1,7	- 1,5	- 5,1	+ 2,1	- 1,3	- 0,6
Relative unit labor costs ²						
Vis-à-vis trading partners	- 0,9	- 2,4	- 6,0	± 0,0	- 2,7	- 0,6
Vis-à-vis Germany	+ 0,4	- 1,1	- 2,4	± 0,0	- 3,6	- 1,2
Effective exchange rate - manufactures						
Nominal	+ 2,5	+ 0,6	- 2,7	+ 0,9	+ 0,4	+ 0,6
Real	+ 0,5	- 1,3	- 3,5	+ 0,3	± 0,0	± 0,0

¹ Employees according to National Accounts definition.-

² Manufacturing, in a common currency; minus sign indicates improvement of competitiveness.

WIFO

Projections - September 2002

Labour market

Changes from previous year (in 1,000)

	1998	1999	2000	2001	2002	2003	
Demand for labour							
Civilian employment	+ 22,1	+ 32,2	+ 27,7	+ 15,9	+ 9,1	+ 33,9	
Excluding parental leave and military service	+ 30,8	+ 38,2	+ 30,8	+ 15,1	- 11,9	+ 14,9	
Dependent employment ¹	+ 21,1	+ 31,2	+ 25,8	+ 14,4	+ 8,0	+ 32,0	
Excluding parental leave and military service	+ 29,8	+ 37,2	+ 28,9	+ 13,6	- 13,0	+ 13,0	
<i>Percentage changes from previous year</i>	+ 1,0	+ 1,2	+ 1,0	+ 0,4	- 0,4	+ 0,4	
Parental leave and military service ¹	- 8,7	- 6,0	- 3,1	+ 0,8	+ 21,0	+ 19,0	
Foreign workers	- 0,2	+ 7,8	+ 13,4	+ 9,5	+ 4,0	+ 9,5	
Self-employed ²	+ 1,0	+ 1,0	+ 1,9	+ 1,5	+ 1,1	+ 1,9	
Labour supply							
Economically active population	(15-64)	+ 11,0	+ 19,8	+ 25,2	+ 28,1	+ 22,9	+ 19,1
	(15-59)	+ 10,9	- 2,6	- 17,5	- 14,2	- 5,5	+ 3,1
Total labour force		+ 26,5	+ 16,2	+ 0,3	+ 25,5	+ 40,1	+ 33,9
Excluding parental leave and military service		+ 35,2	+ 22,2	+ 3,4	+ 24,7	+ 19,1	+ 14,9
Foreign		+ 0,7	+ 6,6	+ 12,0	+ 14,3	+ 10,0	+ 10,0
Migration of nationals		+ 3,9	+ 3,0	+ 1,0	- 1,0	± 0,0	- 0,5
Indigenous		+ 21,9	+ 6,6	- 12,7	+ 12,2	+ 30,1	+ 24,4
Excluding parental leave and military service		+ 30,6	+ 12,6	- 9,6	+ 11,4	+ 9,1	+ 5,4
Surplus of labour							
Registered unemployed ³		+ 4,4	- 16,1	- 27,4	+ 9,6	+ 31,0	± 0,0
In 1,000		237,8	221,7	194,3	203,9	234,9	234,9
Unemployment rate							
Percent of total labour force ⁴	%	4,5	3,9	3,7	3,6	4,1	4,1
Percent of total labour force ³	%	6,5	6,0	5,3	5,5	6,2	6,2
Percent of dependent labour force ³	%	7,2	6,7	5,8	6,1	6,9	6,9
Participation rate⁵							
Excluding parental leave and military service ⁶	%	67,6	67,6	67,3	67,5	67,9	68,3
Employment rate⁷							
Excluding parental leave and military service ⁶	%	63,2	63,6	63,8	63,8	63,7	64,1
Excluding parental leave and military service ⁶	%	66,1	66,9	67,7	68,2	68,0	68,3

¹ According to Federation of Austrian Social Security Institutions.- ² According to WIFO.- ³ According to Labour Market Service.- ⁴ According to Eurostat.- ⁵ Total labour force as percent of economically active population (15-64).-

⁶ As percent of population aged 15 to 59.- ⁷ Employment as percent of economically active population (15-64).

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