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MARKED DECELERATION OF GROWTH DUE TO WEAKER EXTERNAL ENVIRONMENT

ECONOMIC OUTLOOK FOR 2001 AND 2002

Economic growth in Austria is set to slow from 3.2 percent last year to 2.2 percent in 2001, possibly keeping that pace in 2002. The deceleration is caused mainly by less favourable developments in the world economy, and in particular the significant downturn in the USA. A restrictive stance in Austrian budgetary policy will make for domestic growth lagging behind that of the euro area as a whole. Weaker cyclical activity will also make it more difficult to achieve budget balance in the general government accounts by 2002. Unemployment will edge down further in the current year, before stabilising at a rate of 3½ percent of the labour force.

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In the last quarter 2000, the Austrian economy expanded by 2.6 percent in volume, year-on-year. The strength in exports led to substantial gains in machinery and equipment investment and in manufacturing output. Industrial production rose by more than 8 percent for the year as a whole, the strongest increase within the last three decades. The deterioration in the external economic environment will, however, now lead to a noticeable slowdown in cyclical activity. In the USA, growth has fallen sharply and may not exceed a meagre 1 percent this year. This will negatively affect trading partners in North and South America, whose economic situation is fragile already now. Activity in Asia will be undermined further by the persistent stagnation in Japan.

GDP in the euro area is projected to rise by an inflation-adjusted 2.4 percent this year. Activity will, with a certain time-lag, be dampened by slackening foreign trade with the USA which in the more exposed economies accounts for 10 to 20 percent of the total. A possible appreciation of the euro may act as a further drag on exports. On the other hand, comprehensive and appropriately-timed tax cuts in several EU countries should contribute towards stabilising activity. Business cycle hopes in Europe are now directed towards consumer demand. The ECB is hesitating with cutting interest rates. The risks to the present projections derive from the external European environment: should domestic demand prove less robust than expected, growth could fall below the rates assumed here.

Slackening activity in major trading partner countries is effectively constraining growth of domestic exports, despite price competitiveness remaining high. Goods exports may rise by only 6.2 percent in volume this year, with dampening consequences for machinery and equipment investment (+2.8 percent) and manufacturing output (+3.8 percent). The strong link between exports and imports, and the fall in oil prices will lead to weaker import growth. Thus, the deficits in the trade and in the current account balances may remain somewhat below the levels recorded last year.

Domestic demand is expected to advance at a notably more moderate pace than last year. The main reason is the large-scale increase in direct and indirect taxes. Growth in net real disposable income from employment and social transfers is set to abate from 2¼ percent in 2000 to only ½ percent. Assuming a sizeable decline in the household saving ratio, private consumption may still advance by 2 percent. Construction activity is expected to remain subdued (+1½ percent). New home building is falling, although somewhat less strongly than could be expected from the shrinking demand for dwellings. Conditions are relatively better for the construction of office buildings and for civil engineering.

Table 1: Main results

	1997	1998	1999	2000	2001	2002
	Percentage changes from previous year					
GDP						
Volume	+ 1.3	+ 3.3	+ 2.8	+ 3.2	+ 2.2	+ 2.1
Value	+ 2.6	+ 4.0	+ 3.7	+ 4.5	+ 3.8	+ 3.6
Manufacturing ¹ , volume	+ 4.2	+ 4.4	+ 2.4	+ 8.2	+ 3.8	+ 3.0
Private consumption expenditure, volume	+ 1.4	+ 2.9	+ 2.3	+ 2.7	+ 2.0	+ 2.0
Gross fixed investment, volume	+ 1.0	+ 2.7	+ 3.2	+ 2.9	+ 2.1	+ 2.5
Machinery and equipment ²	+ 5.4	+ 5.2	+ 4.6	+ 5.1	+ 2.8	+ 3.8
Construction	- 2.0	+ 0.9	+ 2.2	+ 1.2	+ 1.5	+ 1.5
Exports of goods ³						
Volume	+ 16.5	+ 8.1	+ 7.7	+ 10.9	+ 6.2	+ 5.0
Value	+ 16.8	+ 8.4	+ 7.0	+ 14.8	+ 8.1	+ 7.3
Imports of goods ³						
Volume	+ 9.4	+ 7.1	+ 6.9	+ 7.7	+ 5.8	+ 4.5
Value	+ 10.9	+ 6.6	+ 6.7	+ 13.7	+ 7.2	+ 6.6
Current balance						
billion ATS	- 79.2	- 64.5	- 75.1	- 89.5	- 85.8	- 88.3
billion EUR			- 5.5	- 6.5	- 6.2	- 6.4
as a percentage of GDP	- 3.2	- 2.5	- 2.8	- 3.2	- 2.9	- 2.9
Long-term interest rate ⁴	5.7	4.7	4.7	5.6	4.7	4.7
Consumer prices	+ 1.3	+ 0.9	+ 0.6	+ 2.3	+ 1.7	+ 1.3
Unemployment rate						
percent of total labour force ⁵	4.4	4.5	4.0	3.7	3.6	3.6
percent of dependent labour force ⁶	7.1	7.2	6.7	5.8	5.4	5.5
Dependent employment ⁷	+ 0.4	+ 1.0	+ 1.2	+ 1.0	+ 0.6	+ 0.5
General government financial balance						
as a percentage of GDP	- 1.7	- 2.3	- 2.1	- 1.1	- 0.4	± 0.0

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.

Public revenues increased strongly in 2000, due to lively economic activity and increases in indirect taxes; a further boost came from auction sales of UMTS licenses. The general government deficit was reduced to 1.1 percent of GDP. Sizeable tax increases as from early 2001 will cut the deficit ratio further to around 0.4 percent. The downward revision of forecasted GDP growth being mainly related to weaker exports, the implicit short-term impact on public finances is considered limited. Further progress in consolidation in 2002 will be much more difficult to achieve. While a number of expenditure restraint measures will take effect, costly new family benefits will be introduced, and weaker cyclical activity will leave its marks on the budget. Slower growth, as envisaged in the new projections, will burden the public sector balance by about 0.3 percent of GDP. Given the more favourable budgetary developments in the current year, the aimed-for budget balance in 2002 may still be achieved, provided strict control over expenditure is maintained, and activity does not turn out weaker than assumed in the present forecast.

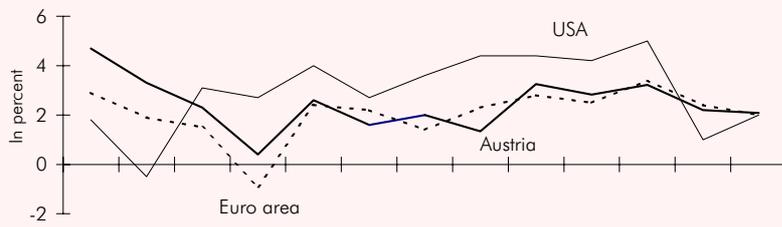
Inflation is expected to recede from 2.3 percent last year to 1.7 percent in 2001, owing much to lower energy prices. Price rises of manufactures, on the other hand, are set to accelerate, and food prices may weaken less than anticipated, in view of a surprising increase in meat prices. Possible inflationary effects in the context of the change-over to euro notes and coins constitute a factor of uncertainty for price developments which, in all, should nevertheless stay calm in 2002.

The slowdown of growth will lead to somewhat smaller employment gains. In the private services sector, however, labour demand is set to remain strong. The number of dependent employees (excluding people on maternity leave and in military service) should rise by around 18,000 or 0.6 percent. Labour supply will be influenced by several factors working in different direction: the population of working age (15 to 59 years old) is shrinking significantly in 2001; labour force participation rates are also on a downward trend, particularly those of the upper age groups; activity of women is influenced by easier access of foreign women to the domestic labour market and, next year, also by the introduction of new childcare benefits. Average unemployment is expected to decline to 181,000 in 2001, corresponding to rates of unemployment of 3.6 percent of the la-

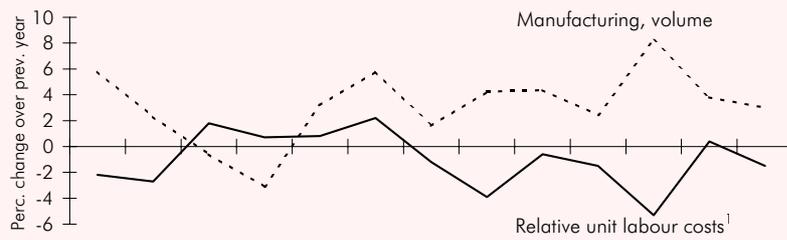
bour force (EU Labour Force Survey) and 5.4 percent of dependent employment (national definitions), remaining broadly unchanged in 2002.

Figure 1: International context

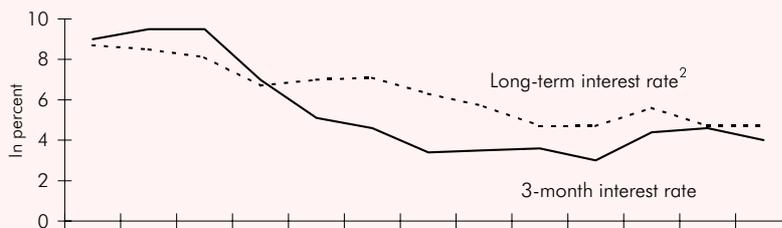
Growth of real GDP



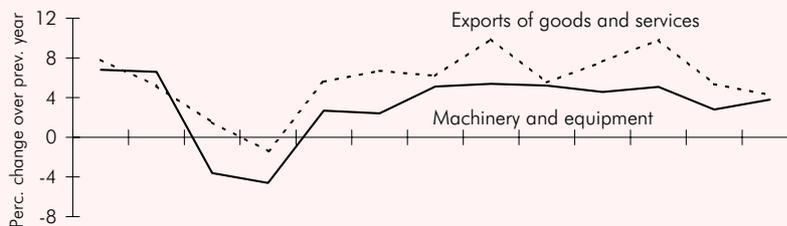
Competitiveness and manufacturing output



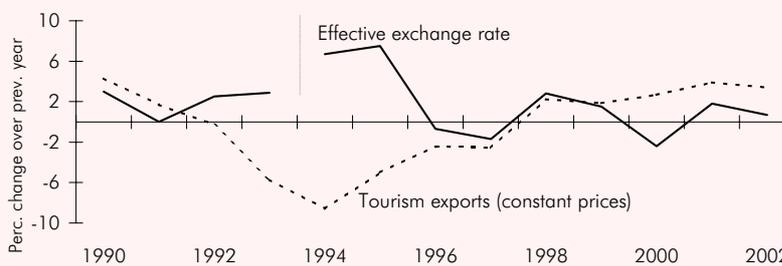
Short-term and long-term interest rates



Exports and gross fixed investment (constant prices)



Tourism and exchange rate



¹ Manufacturing; in a common currency vis-à-vis trading partners. – ² 10-year central government bonds (benchmark).

Activity in the USA declined steeply in the second half 2000. In the 4th quarter, demand and output edged up by only 0.3 percent in volume from the previous period, with machinery and equipment investment and inventory levels shrinking. Manufacturing industry is hit by recession. Private consumer expenditure is still lending support to activity, with volume retail sales rising further in January and February. Consumer confidence has, however, dropped drastically early this year, in view of the slump in equity markets and of fears of rising unemployment.

Already in its projections of last December, WIFO was more pessimistic on the USA's outlook than most other international observers¹. At that time, volume GDP growth had been projected at 2.3 percent, mainly on account of an inverted interest rate yield structure. In the light of more recent developments, this assumption has to be revised further downward. The new projection for GDP growth in 2001 is 1 percent (following the average rise by 5 percent in 2000). The advent of a recession after a long period of cyclical expansion is, taken by itself, not surprising – past experience shows downturns every ten years or so (1982, 1991). The current uncertainty relates to the deepness and duration of the slowdown. A key determinant will be the further development on equity and real estate markets. In the event of a significant fall of the investment ratio and a sharp increase in the private household saving ratio, a further weakening of activity and an extended period of sluggishness would become more likely.

The determined action of monetary policy – short-term interest rates have been cut by 1½ percentage points since early this year – and the imminent tax reductions, as well as a possible depreciation of the dollar, should, on the other hand, underpin a recovery. Moreover, booming investment in information and communication technology over the last years, by now accounting for more than half of total machinery and equipment investment, could lead to timely demand for replacement. WIFO therefore expects U.S. growth in 2002 to pick up to 2 percent.

Sharp downturn in U.S. growth

Already towards the end of last year, the industrial sector in the USA slipped into recession. At present, private consumption is still acting as a stabilising force. Its further evolution will be largely determined by prices on stock and real estate markets. On annual average, GDP is expected to rise by a mere 1 percent. Recovery in 2002 should be supported by expansionary monetary and fiscal policies.

Table 2: World economy

	1997	1998	1999	2000	2001	2002
	Percentage changes from previous year					
<i>Real GDP</i>						
Total OECD	+ 3.1	+ 2.3	+ 2.6	+ 3.6	+ 1.3	+ 1.7
USA	+ 4.4	+ 4.4	+ 4.2	+ 5.0	+ 1.0	+ 2.0
Japan	+ 1.8	- 1.1	+ 0.8	+ 1.7	± 0.0	+ 1.0
EU	+ 2.5	+ 2.8	+ 2.5	+ 3.3	+ 2.3	+ 1.8
Euro area	+ 2.3	+ 2.8	+ 2.5	+ 3.4	+ 2.4	+ 2.0
Germany	+ 1.4	+ 2.1	+ 1.6	+ 3.0	+ 2.1	+ 1.8
Central Eastern Europe ¹	+ 5.0	+ 3.5	+ 3.3	+ 4.2	+ 3.0	+ 3.0
<i>World trade, volume</i>						
OECD exports	+ 10.0	+ 5.6	+ 6.2	+ 13.0	+ 4.5	+ 5.5
OECD imports	+ 10.7	+ 5.6	+ 5.0	+ 13.0	+ 3.5	+ 5.0
Intra-OECD trade	+ 11.3	+ 8.3	+ 7.5	+ 12.3	+ 4.0	+ 6.0
<i>Market growth²</i>						
	+ 10.3	+ 10.6	+ 6.7	+ 10.8	+ 5.5	+ 5.0
<i>Primary commodity prices, in USD</i>						
HWVA index, total, 1990 = 100	- 2.0	- 22.0	- 12.0	+ 31.0	- 10.0	+ 3.0
Excluding energy	+ 0.0	- 13.0	- 8.0	+ 1.0	- 1.0	+ 2.0
<i>Crude oil prices</i>						
Average import price (cif) for OECD countries	USD per barrel					
	19.1	12.6	17.3	28.0	24.0	25.0
<i>Exchange rate</i>						
	USD per ECU or EUR					
	1.134	1.121	1.067	0.92	1.00	1.05

¹ Poland, Slovakia, Slovenia, Czech Republic, Hungary. – ² Real import growth of trading partners weighted by Austrian export shares.

The slowdown in the USA will have a direct dampening impact on trading partners in NAFTA, and on a number of economies in Latin America; Argentina is already struggling with a severe economic crisis. Sluggish activity in America and the recession in Japan are also hampering the recovery in South-East Asia.

¹ Walterskirchen, E., "Temporary Slowdown in Economic Growth. Economic Outlook for 2001 und 2002", Austrian Economic Quarterly, 2001, 6(1).

Despite the entire area's relatively low trade exposure towards the rest of the world, activity in Europe has over the past decades always reacted, with a certain lag, to strong cyclical variations in the USA. The share of trade with the USA is comparatively high for the U.K. and Ireland, the Scandinavian countries and Germany. Industrial confidence in these countries has already weakened significantly since early this year, according to the regular survey by the EU Commission. However, the implementation of Monetary Union should now help rein back negative repercussions of the U.S. slowdown, since a possible depreciation of the dollar can no longer provoke exchange rate turmoil within the euro area.

Effective support to activity in Europe comes from healthy consumer demand in France, Spain and several smaller economies, where private household confidence remains well above the long-term average. Such confidence is in some cases fostered by income tax cuts introduced at the beginning of the year, which are estimated to boost disposable income for the euro area as a whole by ½ percent or more. In the face of slackening exports and the implicit dampening impact on business investment in machinery and equipment, consumer demand remains the mainstay of growth in Europe.

The European Central Bank has so far not reacted to the weaker business cycle outlook. It has its main focus of attention fixed on the rate of inflation, which, due to the echo-effects of the oil price hike and a somewhat surprising rise of meat prices, is still hovering above the 2 percent benchmark: the Harmonised Index of Consumer Prices (HICP) shows for January and February annual advances of 2.4 and 2.6 percent, respectively. Against the background of an imminent weakening of activity, a move towards lower interest rates may be expected over the months to come.

Given the slide in U.S. stock markets, weaker activity, and the aggressive interest rate cuts, a depreciation of the dollar vis-à-vis the euro would not have come as a surprise; this has, however, not occurred. The present assumptions on further developments in the USA and in Europe would still suggest a stronger euro, although exchange rate trends have in the past proved largely independent from fundamentals. Underlying the present projections is the assumption of approximate parity to the dollar on average 2001; a stronger euro appreciation would act as a further drag on exports.

Output in the euro area should remain firm until mid-2001, supported by lively internal demand, before reacting to the global slowdown. GDP growth may average 2½ percent or slightly less this year, reaching a trough of around 2 percent in 2002.

In Germany, demand and output are set to rise by a moderate 2 percent in volume in 2001, trailing once again the euro area average. The high export dependency of German manufacturing industry is taking its toll on business activity. Private consumption proved sluggish towards end-2000, while income tax cuts to the tune of around ¾ percent of GDP in net terms may lead to a slight pick-up in the current year. Construction orders, on the other hand, point to a further marked fall in the industry's output.

As cyclical developments in the EU accession countries in Eastern Europe are largely dependent from Western European demand, some deceleration of growth should be expected. The catching-up process is making rather slow progress. Poland is confronted with a high current account deficit, which forces monetary policy to follow a course of pronounced restriction.

Merchandise exports and manufacturing output remained firmly upward bound until November 2000. Industry benefited from lively demand in key trading partner countries and from high cost-competitiveness. On annual average 2000, goods exports expanded by an estimated 11 percent in volume. Value added in manufacturing gained more than 8 percent, the biggest increase within the last three decades.

The global cyclical slowdown and weakening activity in major trading partner areas are now constraining further growth of Austrian export markets. The latter is projected at a moderate 5½ percent in 2001 and 5 percent in 2002. Favourable developments in unit labour costs which in 2000 alone fell by 5 percent vis-à-vis the average of trading partners, should allow domestic exporters to gain foreign market shares. Nevertheless, export growth is set to abate to little more than 6 percent in volume terms in 2001 and 5 percent in 2002.

Slower export growth will dampen further gains in manufacturing output and investment in machinery and equipment. In the last WIFO business survey for the first quarter 2001, producers of basic goods and of technical manufactures saw their current business situation clearly less satisfactory than three months earlier. Total manufacturing value added may increase by only 3.8 percent this year and 3 percent in 2002. The poorer

Domestic demand will shield European economy from recessionary forces

Slackening of exports, manufacturing output and investment

Those sectors of the Austrian economy that are driven by exports performed strongly in 2000. With world demand growth levelling off, export growth is decelerating markedly and will lead to a slower pace of machinery and equipment investment and of manufacturing output.

sales outlook will dampen firms' readiness to invest, as witnessed already in the last WIFO investment survey. Nevertheless, the general climate of rising competitive pressure, and the growing importance of information and communication technology will provide incentives for renewal of capital stock. Investment in machinery and equipment is thus expected to decelerate to an inflation-adjusted 2.8 percent in 2001 and pick up to 3.8 percent in 2002.

Table 3: Productivity

	1997	1998	1999	2000	2001	2002
	Percentage changes from previous year					
<i>Total economy</i>						
Real GDP	+ 1.3	+ 3.3	+ 2.8	+ 3.2	+ 2.2	+ 2.1
Employment ¹	+ 0.5	+ 0.8	+ 1.4	+ 0.9	+ 0.8	+ 0.6
Full-time equivalent	+ 0.2	+ 0.2	+ 0.6	+ 0.6	+ 0.3	+ 0.2
Productivity (GDP per employment)	+ 0.8	+ 2.5	+ 1.4	+ 2.3	+ 1.4	+ 1.5
Full-time equivalent	+ 1.2	+ 3.0	+ 2.2	+ 2.6	+ 1.9	+ 1.9
<i>Manufacturing</i>						
Production ²	+ 4.3	+ 4.5	+ 2.4	+ 8.2	+ 3.8	+ 3.0
Employees ³	- 1.4	+ 0.1	- 0.7	+ 0.0	- 0.5	- 1.5
Productivity per hour	+ 5.9	+ 4.3	+ 3.8	+ 8.0	+ 4.5	+ 4.6
Working hours per day for employee ⁴	- 0.1	+ 0.1	- 0.6	+ 0.2	- 0.2	± 0.0

¹ Dependent and self-employed according to National Accounts. – ² Value added. – ³ According to Association of Austrian Social Security Bodies. – ⁴ According to "Konjunkturerhebung" of Statistics Austria.

Slower growth of goods exports and business investment is dampening demand also for imported goods. Import values are also held down by lower oil prices and an appreciation of the euro, leading to a slight improvement in the terms of trade. Consumer demand, on the other hand, is fuelling imports, even if demand for durables exhibiting a relatively high import content is rising below-average. Goods imports in 2001 are projected to advance by 5.8 percent in real terms. The trade deficit, expected at around ATS 66 billion, may fall somewhat below the year-earlier level. The foreign balances for tourism and other services (e.g., transport) are in overall surplus which should broadly offset the gap in merchandise trade.

Current account shaped by income and transfer balance flows

Table 4: Private consumption, earnings and prices

	1997	1998	1999	2000	2001	2002
	Percentage changes from previous year, volume					
<i>Private consumption expenditure</i>						
Durables	- 1.2	+ 7.0	+ 8.4	- 0.4	+ 1.0	+ 2.0
Non-durables and services	+ 1.7	+ 2.3	+ 1.4	+ 3.2	+ 2.1	+ 2.0
Net wages and salaries	- 1.8	+ 2.7	+ 2.9	+ 2.3	+ 0.5	+ 1.4
<i>Percentage changes from previous year</i>						
Direct lending to domestic non-banks ¹	+ 3.6	+ 3.7	+ 5.2	+ 6.7	+ 4.3	+ 4.8
<i>Inflation rate</i>						
In percent						
All items	1.3	0.9	0.6	2.3	1.7	1.3
Core inflation ²	1.1	1.2	0.8	1.8	2.4	1.7

¹ End of period. – ² Excluding food and energy items.

The current account deficit which is projected at close to 3 percent of GDP in 2001, is to a substantial degree resulting from net outflows in the incomes and transfer balances. Interest and dividend income of foreign investors and returns from foreign direct investment, as well as Austria's net contribution to the EU budget are tilting the foreign balance towards deficit. Tourism service exports, while gaining momentum, are being outpaced by respective imports.

Consumption grows ahead of modest net income gains

Real disposable income, as derived from employees' earnings after taxes and social transfers, rose by a healthy 2¼ percent in 2000. For 2001, it is expected to edge up by a further ½ percent only, despite somewhat higher wage settlements last autumn. This is explained by the sizeable mark-ups to direct and indirect taxes as part of the budgetary consolidation process. The squeeze in disposable income will also slow private consumption growth to a projected rate of 2 percent in real terms in the current year, with spending on durables expected to rise below-average. This projection is contingent upon a noticeable fall in the private household saving ratio, as has been observed in previous periods of fiscal retrenchment.

The trade sector may see its net sales increase by 2¼ percent in volume, down by nearly 1 percentage point from last year. Wholesale trade will be more negatively affected, due to weaker foreign trade and investment, than retail sales, sustained by rising tourism demand.

Growth of private consumption is set to abate from 2.7 percent last year to 2 percent in 2001.

Substantial tax increases in the context of the fiscal consolidation strategy will allow albeit marginal gains in net disposable incomes.

As observed in the past, households are expected to smooth their consumption path by a lower saving ratio.

Table 5: Earnings and international competitiveness

	1997	1998	1999	2000	2001	2002
	Percentage changes from previous year					
Gross earnings per employee ¹	+ 0.7	+ 3.0	+ 2.0	+ 2.2	+ 2.7	+ 2.2
Full-time equivalent	+ 1.3	+ 3.6	+ 3.0	+ 2.7	+ 3.2	+ 2.6
Gross real earnings per employee	- 0.8	+ 2.5	+ 1.2	+ 0.4	+ 1.0	+ 0.9
Net real earnings per employee	- 2.4	+ 2.3	+ 1.0	+ 0.8	± 0.0	+ 0.4
Net wages and salaries	- 0.3	+ 3.3	+ 3.7	+ 4.1	+ 2.2	+ 2.7
Unit labour costs						
Total economy	+ 0.2	+ 0.7	+ 0.9	+ 0.2	+ 1.3	+ 0.5
Manufacturing	- 4.4	- 1.7	- 0.5	- 5.4	- 1.4	- 2.0
Relative unit labour costs ²						
Vis-à-vis trading partners	- 3.9	- 0.6	- 1.5	- 5.3	+ 0.4	- 1.5
Vis-à-vis Germany	+ 0.8	+ 0.4	- 0.1	- 1.8	- 0.4	- 1.3
Effective exchange rate – manufactures						
Nominal	- 1.8	+ 2.5	+ 0.6	- 2.7	+ 1.6	+ 0.6
Real	- 4.3	+ 0.5	- 1.3	- 3.4	+ 0.7	- 0.1

¹ According to National Accounts. ² Manufacturing, in a common currency; minus sign indicates improvement of competitiveness.

Demand for new homes has fallen markedly from its peak in 1998. Construction of new dwellings has also declined, but to a lesser extent, as the Federal states still had comfortable amounts of residential construction subsidies to spend. Given the medium-term demand prospects, part of these subsidies should be either cut or re-allocated without delay. Public funds could be put to more productive use either in the renovation of existing buildings or the much-needed improvement of transportation links with Eastern Europe, which would help Austria to fully benefit from growth opportunities offered by EU Eastern enlargement. Demand for new office space continues to be strong, while that for industrial buildings may weaken with the projected slackening of investment. In all, construction output may increase by an inflation-adjusted 1½ percent both in 2001 and 2002.

Consumer price inflation remains relatively high, attaining 3.0 percent in January and 2.6 percent in February. The major driving forces are the past hike in energy prices and higher indirect taxes and public charges. But also price rises for manufactured goods are gaining momentum. Food prices are easing less than expected, partly due to a somewhat surprising temporary jump in meat prices. Cigarettes, of late, were more expensive by 6 percent than a year earlier.

In the further course of the year, inflation should subside markedly. Energy prices are already heading downwards, as weakening global demand is bearing down on crude oil prices (expected at USD 24 per barrel on annual average), and with some appreciation of the euro helping. As from June, the base effect of hefty tax increases for energy and motor cars and of raises in public charges will disappear, which has added ½ percentage point to the inflation rate. Taking into account both items, the 2001 average rate of inflation should moderate to 1.7 percent.

Competitive circumstances permitting, firms are trying to pass last year's increases in energy costs onto their sales prices. Manufactured goods may thus become more expensive by an average 1.5 percent this year, compared with +0.8 percent in 2000. Core

Lagging adjustment of construction output

Gradual deceleration of inflation

The fall in energy prices is dampening consumer price inflation which, at the beginning of the year, was relatively high, due to a surprising rise in meat prices and price increases for tobacco. For the whole year 2001, headline inflation is expected at 1.7 percent.

inflation (excluding food and energy components) is projected to accelerate from 1.8 to 2.4 percent.

Overall price stability should be broadly maintained in 2002, as neither oil prices or exchange rates, nor unit labour costs are expected to exert substantial upward pressure. An element of uncertainty are possible price effects deriving from the change-over from schilling to euro notes and coins. As consumer organisations will have an eye on any gains from rounding-up prices in euro during the actual conversion period, firms may be tempted to carry forward any upward price adjustments towards mid-2001.

The number of dependent employees increased by a strong 28,900 (excluding people on maternity leave and in military service) for the whole of 2000, although gains were modest in the second half as labour demand weakened in public administration, transport, education and construction. The current slowdown in economic activity may have a further dampening effect on job creation, even if it directly affects sectors such as exports and manufacturing, whose employment intensity is comparatively low, while service jobs depending primarily on domestic demand and where part-time work is becoming more widespread, appear more sheltered. For this reason, the deceleration in job creation is seen limited in 2001 (net increase of 18,000 or 0.6 percent).

Employment growth moving onto a flatter trend

Table 6: Labour market

	1997	1998	1999	2000	2001	2002
	Changes from previous year, in 1,000					
<i>Demand for labour</i>						
Civilian employment	+ 8.8	+ 22.1	+ 32.2	+ 27.7	+ 17.5	- 2.9
Dependent employment ¹	+ 8.3	+ 21.1	+ 31.2	+ 25.8	+ 15.5	- 5.0
Excluding parental leave and military service	+ 12.8	+ 29.8	+ 37.2	+ 28.9	+ 18.0	+ 15.0
Percentage changes from previous year	+ 0.4	+ 1.0	+ 1.2	+ 1.0	+ 0.6	+ 0.5
Parental leave and military service ¹	- 4.4	- 8.7	- 6.0	- 3.1	- 2.6	- 20.0
Foreign workers	- 1.6	- 0.2	+ 7.8	+ 13.4	+ 13.1	+ 11.4
Self-employed ²	+ 0.5	+ 1.0	+ 1.0	+ 1.9	+ 2.0	+ 2.1
<i>Labour supply</i>						
Economically active population						
(15-64)	+ 13.5	+ 11.0	+ 19.8	+ 23.1	+ 20.5	+ 19.5
(15-59)	+ 20.3	+ 10.9	- 2.6	- 19.3	- 20.6	- 8.6
Total labour force	+ 11.7	+ 26.5	+ 16.2	+ 0.3	+ 4.1	- 2.0
Foreign	- 1.7	+ 0.7	+ 6.6	+ 12.0	+ 15.0	+ 10.0
Migration of nationals	+ 5.4	+ 3.9	+ 3.0	- 3.0	- 2.5	- 2.5
Indigenous	+ 8.0	+ 21.9	+ 6.6	- 8.7	- 8.4	- 9.5
<i>Surplus of labour</i>						
Registered unemployed ³	+ 2.8	+ 4.4	- 16.1	- 27.4	- 13.3	+ 0.9
in 1,000	233.3	237.8	221.7	194.3	181.0	181.9
<i>Unemployment rate</i>						
According to Eurostat (percent of total labour force)	4.4	4.5	4.0	3.7	3.6	3.6
According to AMS (percent of total labour force)	6.4	6.5	6.0	5.3	4.9	4.9
According to AMS (percent of dependent labour force)	7.1	7.2	6.7	5.8	5.4	5.5
Participation rate ⁴	67.2	67.6	67.6	67.4	67.2	66.9
Employment rate ⁵	62.9	63.2	63.6	63.8	63.9	63.6

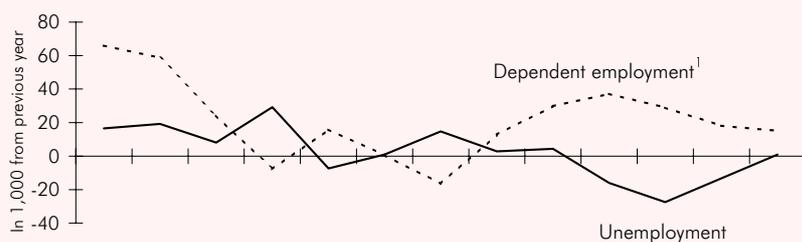
¹ According to Association of Austrian Social Security Bodies. - ² According to WIFO. - ³ According to Labour Market Service. - ⁴ Total labour force as a percentage of active population (aged 15 to 64). - ⁵ Employment as a percentage of active population (aged 15 to 64).

The projection of labour supply poses some difficulties. The demographic projection implies a further considerable squeeze in the population of working age (15 to 59 year olds). Labour force participation remains on a downward trend, notably for the higher age groups (partly due to early retirement becoming more common in the civil service). Participation rates are broadly flat for the low age groups of new job entrants, but are rising for younger and middle-aged women, as existing restrictions of access to the domestic labour market for foreign women have been relaxed. The introduction of generalised child-care benefits as from 2002 could weaken women's incentives to work, but could induce as well part-time work, as the income ceilings to which the new benefits are subject is rather high.

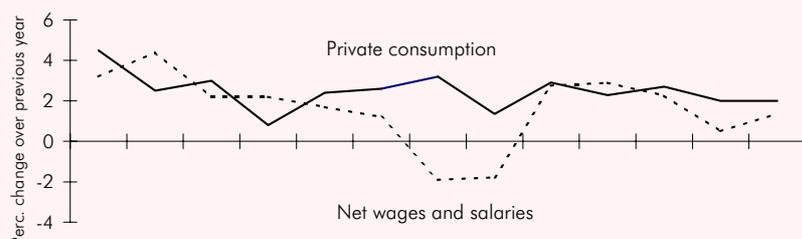
The projected trends of labour demand and supply suggest that registered unemployment may fall by a further 13,000 to a total of 181,000 on annual average. This would correspond to a rate of 3.6 percent of the total labour force, following EU statistical criteria, or 5.4 percent of the dependent labour force according to the Austrian conventional way of calculation. The projection implies that existing programmes of active labour market policy will be continued to full extent.

Figure 2: Economic performance

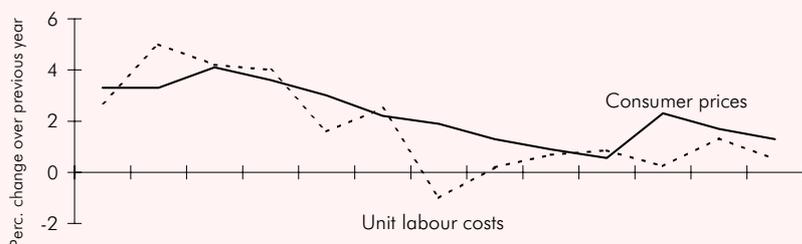
Employment and unemployment



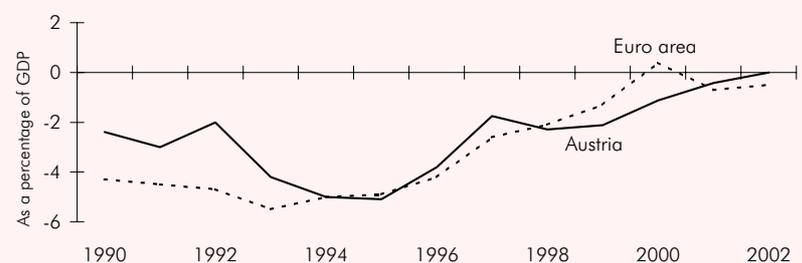
Private consumption and earnings (constant prices)



Inflation and unit labour costs



General government financial balance



¹ Excluding parental leave and military service.

While the projected profile of cyclical activity should allow further modest employment gains in 2002 (+0.5 percent), unemployment may stop declining. As different from objectives defined at the European level providing for an increase in the employment ratio between now and 2010, labour force participation is currently falling in Austria. In a medium-term perspective, this may be a cause for concern with regard to the financial viability of the public retirement system.

Lively exports and private consumption boosted general government revenues in 2000. Additional receipts came from higher indirect taxes and the sale of UMTS licenses. The overall general government deficit fell by around 1 percentage point to a ratio of 1.1 percent of GDP.

With effect from 1 January 2001, a comprehensive set of tax increases, affecting both wage earners and the corporate sector, was introduced which, together with last year's raise in indirect taxes, will increase government revenues by some ATS 35 billion. Public expenditures have been budgeted with a comfortable safety margin, leaving room for manoeuvre and for yet undetermined liability accruals. The weakening of activity should have relatively little impact on the budget, as it is primarily related to exports and the downward correction is smaller for nominal than for volume GDP growth. The general

**Slower growth makes
budgetary
consolidation more
difficult, but zero-
deficit may still be
achieved**

government deficit of around 0.4 percent of GDP according to the present projections is significantly lower than expected by the Ministry of Finance.

Table 7: Key policy indicators

		1997	1998	1999	2000	2001	2002
<i>Fiscal policy</i>							
Central government net balance	billion ATS	- 66.7	- 76.0	- 63.4	- 45.3	- 32.4	- 23.0
	as a percentage of GDP	- 2.7	- 2.9	- 2.3	- 1.6	- 1.1	- 0.75
General government financial balance	as a percentage of GDP	- 1.7	- 2.3	- 2.1	- 1.1	- 0.4	± 0.0
General government primary balance	as a percentage of GDP	2.1	1.5	1.4	2.3	3.0	3.3
In percent							
<i>Monetary policy</i>							
3-month interest rate		3.5	3.6	3.0	4.4	4.6	4.0
Long-term interest rate ¹		5.7	4.7	4.7	5.6	4.7	4.7
Percentage changes from previous year							
<i>Effective exchange rate</i>							
Nominal		- 1.7	+ 2.8	+ 1.5	- 2.4	+ 1.8	+ 0.7
Real		- 4.6	+ 0.3	- 1.1	- 3.5	+ 0.8	- 0.1

¹ 10-year central government bonds (benchmark).

Further progress in budgetary consolidation in 2002 will be much more difficult to achieve, as no more revenue-raising measures are foreseen. On the expenditure side, relief may be expected from the latest reform of public pensions, public sector wage increases well below the prospective rate of inflation, and from a number of further spending items being transferred "off budget". On the other hand, newly introduced childcare benefits may prove costly; their detailed regulations and implicit budgetary impact have not been fully clarified as yet. Moreover, the Federal states have committed themselves to substantial budgetary surpluses in order to offset the deficit incurred by the central government. With a view to achieving the surpluses required, "off budget" transfer operations are being carried out on a large scale that still need to be recognised by Eurostat as relevant for the deficit criterion. In addition to such Maastricht-related accounting operations, actual measures of expenditure restraint will prove necessary in order to meet the desired targets.

Unlike in the last two years, cyclical strength should not be expected to support budgetary consolidation in 2002. The projections for income and employment growth are being revised downward, and unemployment may no longer recede. The negative impact of projected slower growth on the general government balance roughly corresponds to 0.3 percent of GDP. The zero-deficit targeted by the government will therefore be achieved only if the utmost discipline is exerted with regard to expenditure increases.

In the event of a steeper-than-projected slowdown of activity, continued adherence to the option of a balanced budget would no longer appear realistic nor, indeed, meaningful, in view of the need for automatic fiscal stabilisers to operate fully in support of the business cycle.

The general government deficit may turn out lower than expected: for 2000, because of stronger cyclical activity; for 2001, as a result of sizeable tax increases. In view of the downward adjustment of growth projections, the target of a balanced budget in 2002 will be difficult to meet.