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Sluggish Recovery in 2003

Economic Outlook for 2003 and 2004

The Austrian economy grew by slightly less than 1 percent in 2002. For 2003, only a gradual recovery of activity should be expected, given the subdued business climate world-wide. GDP growth for Austria, as well as for the euro area, is projected at 1¾ percent, below the medium-term trend. Expectations of firms and consumers are brightening up only slowly, as risks on international financial, real estate and energy markets remain high. The weak momentum of the recovery will prevent both unemployment and the budget deficit from falling in 2003.

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Since last summer, economic prospects for Europe have turned gloomier. Unlike in the USA, the economy has still not overcome the cyclical low. Business and consumer confidence is particularly low in Germany, with adverse consequences not only for the Austrian export and tourism industries outlook, but also for the investment climate. The projection for GDP growth in 2003 has therefore been taken down by ½ percentage point, both for Austria and the euro area as a whole.

In the first nine months of 2002, demand and output in Austria rose by 0.8 percent from last year. While the trend was still positive in the first semester, with seasonally-adjusted real GDP gaining some ½ percent from quarter to quarter, business sentiment weakened as from last summer, reflecting the stock market falls and doubts about the robustness of global business conditions. Output losses caused by the summer flood damages had a further, if temporary, dampening effect on confidence.

Firms' readiness to invest hit a low in 2002. Spending on machinery and equipment dropped by over 10 percent from a year earlier, much more sharply than on average for the EU. Private consumption, however, continued to hold up better than, say, in Germany. Households spent by almost 1 percent more in real terms than in 2001, though cutting substantially on investment-like items such as motor cars and housing. Exports and tourism also proved fairly resilient to the cyclical sluggishness abroad. On markets outside Europe, exporting firms managed to gain market shares.

GDP growth in 2002, at nearly 1 percent, was close to the figure WIFO had projected as early as December 2001 (1.2 percent). However, in the second half of 2002 signs of a stronger pace have largely been absent, such that growth in 2003 is unlikely to exceed 1.7 percent. The WIFO projection is thus virtually identical with that of the Austrian National Bank, the OECD and the European Commission. The underlying scenario implies that activity will pick up markedly as from next summer at the latest. It is underpinned by a tentative consolidation on stock markets in the fourth quarter 2002 and the expectation that the need for replacement will put an end to the restraint on spending on investment and durable consumer goods. The recent interest rate cut by the ECB should further contribute to an alleviation of debt burdens and an improvement in private sector confidence. However, fiscal retrenchment in some of the larger EU countries may exert a dampening influence in 2003, providing a major risk in a period of cyclical fragility. The amount of uncertainty is underlined by

the fact that all positive elements cited (catching-up on investment, low interest rates, etc.) would have been in place for an upturn already in 2002. A crucial factor for the timing and strength of such upturn is confidence in the business outlook – confidence that has been undermined by the decline in share prices now lasting for two years¹.

<i>Main results</i>		1999	2000	2001	2002	2003	2004
		Percentage changes from previous year					
GDP							
Volume		+ 2.7	+ 3.5	+ 0.7	+ 0.9	+ 1.7	+ 2.3
Value		+ 3.4	+ 5.0	+ 2.3	+ 1.9	+ 3.0	+ 3.7
Manufacturing ¹ , volume		+ 3.0	+ 6.5	+ 1.3	+ 0.5	+ 2.5	+ 3.5
Private consumption expenditure, volume		+ 2.3	+ 3.3	+ 1.5	+ 0.9	+ 1.7	+ 2.2
Gross fixed investment, volume		+ 2.1	+ 5.9	- 2.2	- 4.6	+ 2.9	+ 3.5
Machinery and equipment ²		+ 4.9	+ 11.8	- 2.9	- 10.0	+ 5.0	+ 6.0
Construction		+ 0.0	+ 1.2	- 1.5	± 0.0	+ 1.2	+ 1.5
Exports of goods ³							
Volume		+ 7.7	+ 13.1	+ 7.5	+ 2.5	+ 5.5	+ 8.5
Value		+ 7.0	+ 15.6	+ 6.5	+ 2.5	+ 6.6	+ 9.6
Imports of goods ³							
Volume		+ 6.9	+ 10.9	+ 5.7	- 3.5	+ 5.8	+ 8.0
Value		+ 6.7	+ 14.7	+ 5.0	- 3.5	+ 6.9	+ 9.1
Current balance	(billion €)	- 6.33	- 5.36	- 4.65	- 0.25	- 0.64	- 0.95
As a percentage of GDP	(%)	- 3.2	- 2.6	- 2.2	- 0.1	- 0.3	- 0.4
Long-term interest rate ⁴	(%)	4.7	5.6	5.1	5.0	4.5	4.7
Consumer prices		+ 0.6	+ 2.3	+ 2.7	+ 1.8	+ 1.5	+ 1.4
Unemployment rate							
Percent of total labour force ⁵	(%)	3.9	3.7	3.6	4.1	4.2	4.0
Percent of dependent labour force ⁶	(%)	6.7	5.8	6.1	6.8	7.0	6.7
Dependent employment ⁷		+ 1.2	+ 1.0	+ 0.4	- 0.5	+ 0.1	+ 0.5
General government financial balance according to Maastricht definition							
As a percentage of GDP	(%)	- 2.3	- 1.5	+ 0.2	- 1.5	- 1.5	- 1.2

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.

The cyclical weakness and tax payments carried forward into 2001 have led to a shortfall in public revenues of around € 2 billion. Mainly for this reason, the general government account exhibited a deficit of some 1½ percent of GDP, as estimated by WIFO. A gap of the same order of magnitude is to be expected for 2003, with the positive impact of somewhat stronger growth likely to be offset by additional spending on counter-cyclical measures and repair of flood damages decided last year.

The slackening of economic activity led to an unusually strong increase in unemployment in 2001 and 2002. While demand for labour weakened more or less in line with the cyclical profile, labour supply increased considerably. By the second half of 2002, the rise in the labour force and the jobless figure levelled off somewhat. The projected gradual recovery in 2003 should put an end to overall job losses and make for but a small further increase in unemployment.

With activity picking up only gradually in 2003, inflation may still decelerate for some time. In this regard, the rising euro exchange rate will play a major role. Underlying the projections is the assumption of parity to the dollar on annual average 2003, corresponding to an appreciation of some 10 percent vis-à-vis 2001. The stronger euro not only holds down prices of imports from the dollar area, but also of such from euro area countries as their inflation is also dampened by the exchange rate effect. Roughly 60 percent of Austria's goods imports are from the euro area. The projections make no allowance for a possible jump in oil prices in the event of a war against Iraq.

Given the uncertainties of the short-term outlook, the scenario for 2004 is necessarily vague at this stage. Growth is deemed most likely to be in the range of 2 to 2½ per-

¹ Kramer, H., "Österreichs Wirtschaft – Betrachtungen zur Jahreswende 2002/03", WIFO Lectures, 2002, (89), http://titian.wsr.ac.at/wifosite/wifosite.get_abstract_type?p_language=1&pubid=23200.

cent for Austria as well as for the euro area. However, experience shows² that projections for the second following year are hardly more accurate than trend extrapolations. However, the December forecast for the following year exhibits a relatively high degree of accuracy – as confirmed also by the WIFO December 2001 forecast.

² Baumgartner, J., "Die Wirtschaftsprognosen von WIFO und IHS. Eine Analyse für die achtziger und neunziger Jahre", WIFO-Monatsberichte, 2002, 75(11), pp. 701-716.