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**Business Activity Keeping Strong
Momentum – Slowdown Expected
Only in 2008**

Economic Outlook for 2006 to 2008

December 2006

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Economic Outlook 2006 to 2008: Business Activity Keeping Strong Momentum – Slowdown Expected Only in 2008

In 2006, the Austrian economy benefited from the cyclical upswing in Europe. The implicit growth impulse translated in the course of the year into higher investment demand. Domestic demand will drive activity also in 2007, even if the "echo effect" from the positive one-off factors at work in 2006 will dampen the year-on-year rate of growth. In 2008, the European business cycle is expected to lose momentum. Nevertheless, GDP growth in Austria should outpace the euro area average. Given the cyclical conditions, the stance of Austrian fiscal policy is expansionary.

In the light of the favourable developments in 2006 and the still optimistic output expectations of firms towards end of the year, WIFO is revising upwards its projection for real GDP growth to a rate of 3¼ percent year-on-year for 2006 and 2¾ percent for 2007. In 2008, the expected cyclical slowdown in Europe will dampen economic growth in Austria to a rate of 2¼ percent.

In the regular WIFO business survey of last November, firms showed continued optimism as regards both the current situation and sales expectations for the coming months. In 2006, manufacturing and construction posted particularly strong gains. Apart from the generally favourable business conditions, both sectors benefited from a number of special factors. In anticipation of the VAT increase in Germany in early 2007, domestic producers notably of motor cars and suppliers of vehicle components enjoyed a demand boost towards the end of 2006, which will, however, be followed by a corresponding temporary setback in 2007. In the construction sector, unusually mild weather allowed many projects to be finalised earlier, leading to unusually strong output in the year-end quarter. Here also, the high carry-over may lead to a year-on-year decline in late 2007.

Export growth has been accelerating since mid-2005, to a projected year-on-year rate of more than 10 percent for volume merchandise exports in 2006. However, slackening demand from overseas, the rise in the euro exchange rate and the negative echo effect from the German VAT increase will moderate export growth to below 8 percent in 2007 and still further in 2008 when business activity also in the euro area is set to lose momentum.

Gross fixed investment is growing at a strong pace. After an increase by over 5 percent in volume in 2006, a similar rate should be attained in 2007. Although construction investment is expected to slow from an inflation-adjusted 5 percent to 3.7 percent, corporate spending on machinery and equipment will be reinforced (2006 +5½ percent, 2007 +6½ percent). In 2008,

both investment components are projected to advance at a more moderate pace, overall by 3½ percent in real terms.

Because of only modest gains in wages and salaries, private consumption growth is not expected to pick up significantly, despite the robust cyclical activity and lively job creation. Adjusted for inflation, private household spending is projected to advance by 1.9 percent in 2006 and 2.1 percent in 2007, keeping a pace of 2 percent in 2008. Against this background, inflation will remain subdued. Second-round effects from higher oil prices are still largely absent, and the strength of the euro is exerting downward pressure on import prices. Following an average rate of 1.4 percent in 2006, headline inflation is set to head up only marginally, to 1.6 percent in 2007 and 1.7 percent in 2008.

The labour market is responding markedly to the cyclical improvement, with total employment increasing by 50,000 in 2006 and a further 40,000 jobs likely to be added in 2007, before subsiding to +21,000 in 2008. Although labour supply remains strongly upward bound, unemployment will decline. The bulk of the newly created jobs will be filled by new entrants to the labour market. In 2006, the jobless figure fell by 13,400, 8,800 of which are accounted for by the reinforcement of job training activities. In 2007, the number of unemployed is projected to moderate by a further 10,000, before levelling off in 2008. The unemployment rate (according to national definitions) is set to head down over the entire projection period, from 6.8 percent in 2006 to 6.4 percent in 2008.

The lively cyclical activity is boosting government revenues to an unexpected extent. The shortfall in corporate tax revenues expected to emerge with a lag as a consequence of the 2004-05 tax reform has so far not materialised. In 2006, the general government deficit narrowed to 1.2 percent of GDP. Despite the continued cyclical strength, the deficit looks set to edge up to 1.4 percent of GDP on the basis of government expenditure committed so far. The projection of an unchanged deficit ratio of 1.4 percent for 2008 is still subject to considerable political uncertainty.

Vienna, 20 December 2006.

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Projections - December 2006

Main results

Percentage changes from previous year

		2003	2004	2005	2006	2007	2008
GDP							
Volume		+ 1.1	+ 2.4	+ 2.0	+ 3.2	+ 2.7	+ 2.3
Value		+ 2.4	+ 4.2	+ 3.9	+ 4.5	+ 4.4	+ 4.0
Manufacturing¹, volume		+ 0.1	+ 2.4	+ 2.4	+ 6.8	+ 5.0	+ 3.0
Wholesale and retail trade, volume		+ 0.5	+ 1.3	+ 0.3	+ 1.4	+ 2.1	+ 1.9
Private consumption expenditure, volume		+ 1.3	+ 1.9	+ 1.7	+ 1.9	+ 2.1	+ 2.0
Gross fixed investment, volume		+ 5.9	+ 0.6	+ 0.3	+ 5.2	+ 4.9	+ 3.4
Machinery and equipment ²		+ 6.8	- 0.7	+ 0.1	+ 5.5	+ 6.5	+ 4.5
Construction		+ 5.1	+ 1.6	+ 0.4	+ 5.0	+ 3.7	+ 2.5
Exports of goods³							
Volume		+ 2.6	+ 12.9	+ 2.2	+ 10.4	+ 7.8	+ 6.8
Value		+ 1.9	+ 13.9	+ 5.4	+ 13.2	+ 8.9	+ 7.3
Imports of goods³							
Volume		+ 6.5	+ 11.4	+ 2.3	+ 7.9	+ 8.2	+ 6.8
Value		+ 5.0	+ 12.5	+ 5.9	+ 12.1	+ 9.5	+ 7.5
Current balance	€ bn	- 0.48	+ 1.08	+ 3.24	+ 4.90	+ 4.94	+ 5.33
	as a percentage of GDP	- 0.2	+ 0.5	+ 1.3	+ 1.9	+ 1.8	+ 1.9
Long-term interest rate⁴	percent	4.2	4.2	3.4	3.8	3.8	4.1
Consumer prices		+ 1.3	+ 2.1	+ 2.3	+ 1.4	+ 1.6	+ 1.7
Unemployment rate							
Eurostat definition ⁵	percent	4.3	4.8	5.2	4.9	4.6	4.5
National definition ⁶	percent	7.0	7.1	7.3	6.8	6.5	6.4
Persons in active dependent employment⁷		+ 0.2	+ 0.7	+ 1.0	+ 1.7	+ 1.3	+ 0.7
General government financial balance							
	according to Maastricht definition						
	as a percentage of GDP	- 1.6	- 1.2	- 1.5	- 1.2	- 1.4	- 1.4

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 Labour Force Survey. ⁶ According to Labour Market Service, percent of total labour force excluding self employed. ⁷ Excluding parental leave, military service, and unemployed persons in training.

WIFO*Projections - December 2006***Key policy indicators**

	2003	2004	2005	2006	2007	2008
<i>Fiscal policy</i>						
	As a percentage of GDP					
General government financial balance						
according to Maastricht definition	- 1.6	- 1.2	- 1.5	- 1.2	- 1.4	- 1.4
according to National accounts	- 1.8	- 1.3	- 1.6	- 1.3	- 1.4	- 1.5
General government primary balance	+ 1.3	+ 1.6	+ 1.3	+ 1.5	+ 1.4	+ 1.3
<i>Monetary policy</i>						
	Percent					
3-month interest rate	2.3	2.1	2.2	3.1	3.7	3.3
Long-term interest rate ¹	4.2	4.2	3.4	3.8	3.8	4.1
	Percentage changes from previous year					
Effective exchange rate						
Nominal	+ 3.8	+ 1.2	- 0.6	+ 0.2	+ 0.6	+ 0.4
Real	+ 2.8	+ 0.9	- 0.7	- 0.7	- 0.2	± 0.0

¹ 10-year central government bonds (benchmark).

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Projections - December 2006

World economy

Percentage changes from previous year

	2003	2004	2005	2006	2007	2008
Real GDP						
World	+ 4.1	+ 5.3	+ 4.9	+ 5.0	+ 4.6	+ 4.6
Total OECD	+ 2.0	+ 3.2	+ 2.7	+ 3.1	+ 2.6	+ 2.6
USA	+ 2.5	+ 3.9	+ 3.2	+ 3.3	+ 2.3	+ 2.8
Japan	+ 1.4	+ 2.7	+ 1.9	+ 2.0	+ 1.9	+ 1.6
EU 25	+ 1.3	+ 2.4	+ 1.7	+ 2.8	+ 2.5	+ 2.2
EU 15	+ 1.1	+ 2.2	+ 1.5	+ 2.7	+ 2.4	+ 2.1
Euro area	+ 0.8	+ 1.9	+ 1.3	+ 2.7	+ 2.4	+ 2.1
Germany	- 0.2	+ 1.2	+ 0.9	+ 2.5	+ 1.9	+ 1.7
New members ¹	+ 3.8	+ 5.1	+ 4.6	+ 5.2	+ 5.0	+ 4.8
China	+ 10.0	+ 10.1	+ 10.2	+ 10.4	+ 9.8	+ 9.2
World trade, volume	+ 5.0	+ 10.3	+ 7.2	+ 9.6	+ 7.7	+ 6.9
Market growth²	+ 5.6	+ 9.1	+ 6.8	+ 9.5	+ 7.3	+ 6.5
Primary commodity prices						
HWWA Index, total	- 4	+ 18	+ 29	+ 27	- 13	- 4
Excluding energy	- 6	+ 18	+ 6	+ 22	- 7	- 4
Crude oil prices						
Average import price (cif) for OECD countries	28.4	36.3	50.3	65.0	60.0	61.0
Exchange rate						
USD per euro	1.131	1.243	1.245	1.25	1.35	1.42

¹ Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia.

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

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Projections - December 2006

Private consumption, income and prices

	2003	2004	2005	2006	2007	2008
	Percentage changes from previous year, volume					
Private consumption expenditure	+ 1.3	+ 1.9	+ 1.7	+ 1.9	+ 2.1	+ 2.0
Durables	+ 3.1	+ 5.1	+ 2.2	+ 1.8	+ 2.8	+ 2.3
Non-durables and services	+ 1.1	+ 1.5	+ 1.6	+ 1.9	+ 2.0	+ 2.0
Household disposable income	+ 2.1	+ 2.0	+ 2.1	+ 2.2	+ 2.1	+ 1.5
Household saving ratio						
As a percentage of disposable income	8.6	8.8	9.1	9.4	9.3	9.0
	Percentage changes from previous year					
Direct lending to domestic non-banks¹	+ 1.6	+ 5.0	+ 4.7	+ 5.9	+ 5.0	+ 5.0
	Percentage changes from previous year					
Inflation rate						
National	1.3	2.1	2.3	1.4	1.6	1.7
Harmonised	1.3	2.0	2.1	1.7	1.8	1.9
Core inflation ²	1.3	1.6	1.5	1.3	2.0	2.0

¹ End of period.

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

Productivity

Percentage changes from previous year

	2003	2004	2005	2006	2007	2008
Total economy						
Real GDP	+ 1.1	+ 2.4	+ 2.0	+ 3.2	+ 2.7	+ 2.3
Employment ¹	- 0.0	- 0.0	+ 0.5	+ 1.2	+ 0.9	+ 0.4
Productivity (GDP per employment)	+ 1.1	+ 2.5	+ 1.6	+ 2.0	+ 1.8	+ 1.9
Manufacturing						
Production ²	+ 0.1	+ 2.3	+ 2.6	+ 6.8	+ 5.0	+ 3.0
Employees ³	- 1.7	- 0.6	- 0.8	+ 0.1	± 0.0	- 0.1
Productivity per hour	+ 1.4	+ 2.0	+ 4.0	+ 6.1	+ 4.8	+ 2.7
Working hours per day per employee ⁴	+ 0.3	+ 0.8	- 0.6	+ 0.6	+ 0.2	+ 0.4

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

² Value added, volume.

³ According to Federation of Austrian Social Security Institutions.

⁴ According to 'Konjunkturerhebung' of Statistics Austria.

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Projections - December 2006

Earnings and international competitiveness

Percentage changes from previous year

	2003	2004	2005	2006	2007	2008
Gross earnings per employee ¹	+ 1.9	+ 1.9	+ 1.7	+ 2.8	+ 2.5	+ 2.5
Gross real earnings per employee ¹	+ 0.3	- 0.0	+ 0.0	+ 1.4	+ 0.9	+ 0.8
Net real earnings per employee ¹	+ 0.0	+ 0.1	+ 1.1	+ 0.8	+ 0.4	+ 0.3
<i>Total economy</i>						
Unit labour costs	+ 0.7	- 0.8	+ 0.2	+ 0.8	+ 0.7	+ 0.6
<i>Manufacturing</i>						
Unit labour costs	+ 0.8	- 0.8	- 0.6	- 3.5	- 2.1	- 0.4
Relative unit labour costs ²						
Vis-à-vis trading partners	+ 3.7	+ 1.8	+ 0.6	- 2.1	- 1.4	- 0.8
Vis-à-vis Germany	+ 2.4	+ 2.2	+ 3.0	± 0.0	± 0.0	+ 0.1
Effective exchange rate - manufactures						
Nominal	+ 3.7	+ 1.2	- 0.5	+ 0.2	+ 0.5	+ 0.3
Real	+ 2.9	+ 1.0	- 0.5	- 0.6	- 0.2	+ 0.1

¹ Employees according to National Accounts definition.

² In a common currency; minus sign indicates improvement of competitiveness.

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Projections - December 2006

Labour market

Changes from previous year (1,000^s)

	2003	2004	2005	2006	2007	2008	
Demand for labour							
Persons in active employment ¹	+ 8.5	+ 25.1	+ 37.2	+ 57.5	+ 45.0	+ 25.5	
Employees ²	+ 5.5	+ 21.1	+ 31.9	+ 52.0	+ 40.0	+ 21.0	
<i>Percentage changes from previous year</i>	+ 0.2	+ 0.7	+ 1.0	+ 1.7	+ 1.3	+ 0.7	
Nationals	- 10.4	+ 9.2	+ 20.0	+ 35.9	+ 27.3	+ 10.3	
Foreign workers	+ 15.9	+ 11.9	+ 11.9	+ 16.1	+ 12.7	+ 10.7	
Self-employed ³	+ 3.0	+ 4.0	+ 5.3	+ 5.5	+ 5.0	+ 4.5	
Labour supply							
Population of working age (15 to 64 years)	+ 37.7	+ 34.4	+ 15.6	+ 21.2	+ 20.3	+ 25.8	
(15 to 59 years)	+ 21.2	+ 35.6	+ 48.5	+ 52.2	+ 24.9	+ 16.1	
Labour force ⁴	+ 16.1	+ 28.9	+ 45.9	+ 44.1	+ 35.0	+ 25.5	
Surplus of labour							
Registered unemployed ⁵	+ 7.7	+ 3.8	+ 8.8	- 13.4	- 10.0	± 0.0	
1,000 ^s	240.1	243.9	252.7	239.3	229.3	229.3	
Unemployment rate							
Eurostat definition ⁶	percent	4.3	4.8	5.2	4.9	4.6	4.5
Percent of total labour force ⁵	percent	6.3	6.4	6.5	6.1	5.8	5.8
National definition ^{5,7}	percent	7.0	7.1	7.3	6.8	6.5	6.4
Employment rate							
Persons in active employment ^{1,8}	percent	62.2	62.3	62.8	63.6	64.1	64.3
Total employment (Eurostat) ^{6,8,9}	percent	-	67.8	68.6	69.3	69.7	69.8

¹ Excluding parental leave, military service, and unemployed persons in training. ² According to Federation of Austrian Social Security Institutions. ³ According to WIFO. ⁴ Economically active employment plus unemployment.

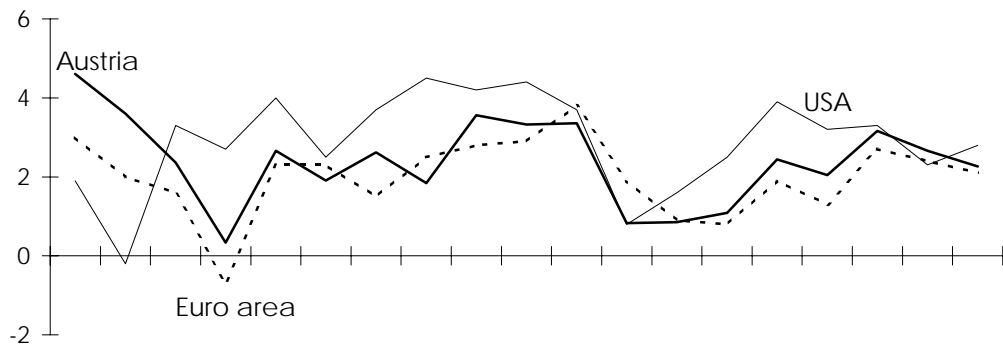
⁵ According to Labour Market Service. ⁶ According to Eurostat Labour Force Survey.

⁷ Percent of total labour force excl. self-employed. ⁸ Percent of population of working age (15 to 64 years).

⁹ Changed survey method.

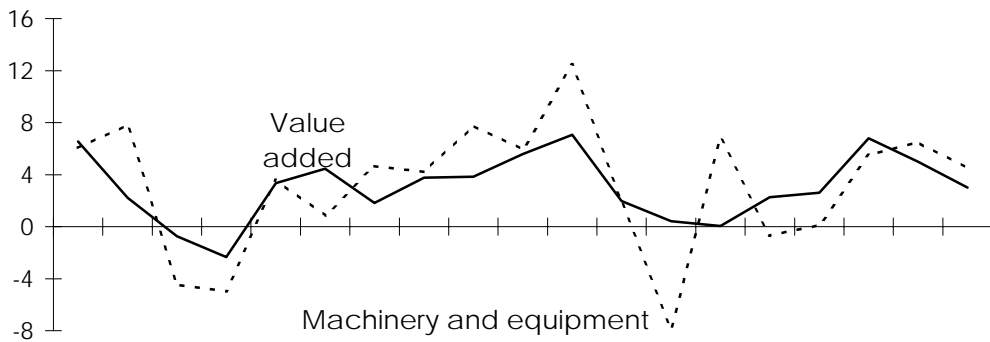
Growth of real GDP

Percent



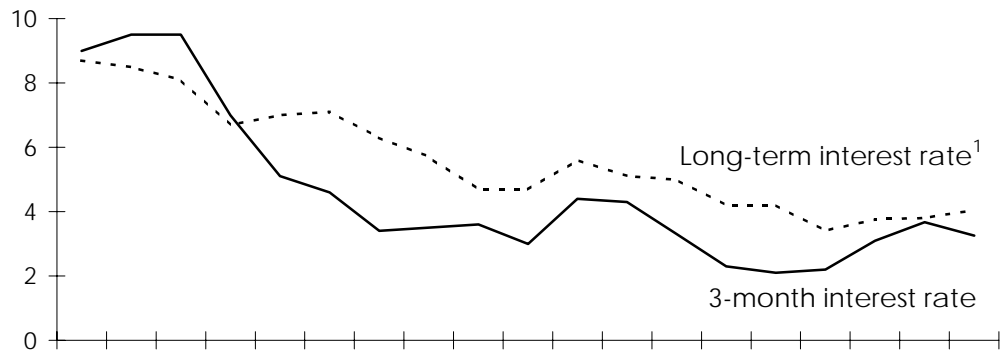
Manufacturing and investment

Percentage changes from previous year, volume



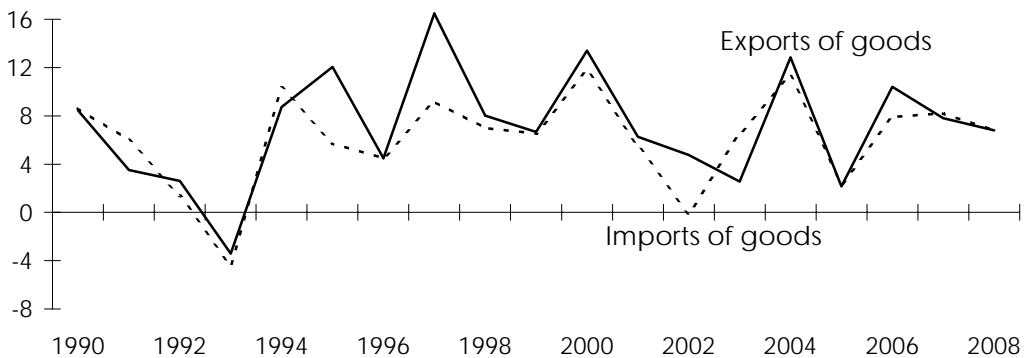
Short-term and long-term interest rates

Percent



Trade

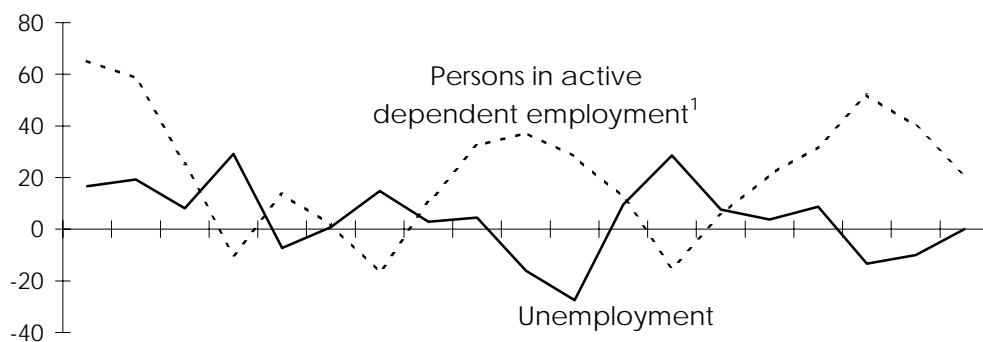
Percentage changes from previous year, volume



¹ 10-year central government bonds (benchmark).

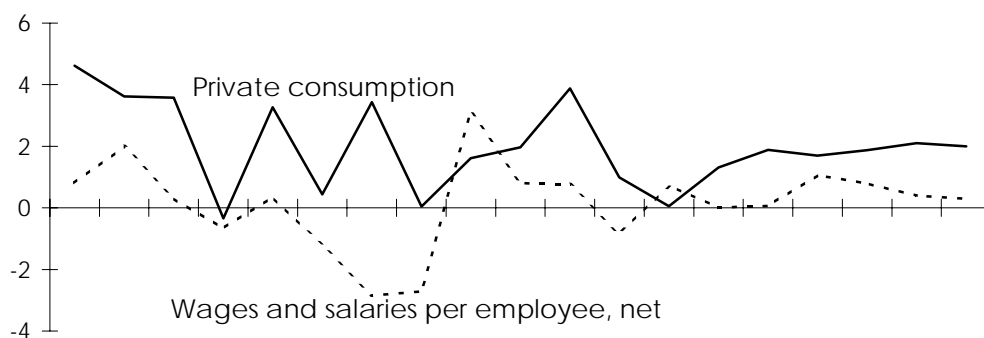
Employment and unemployment

1,000^s from previous year



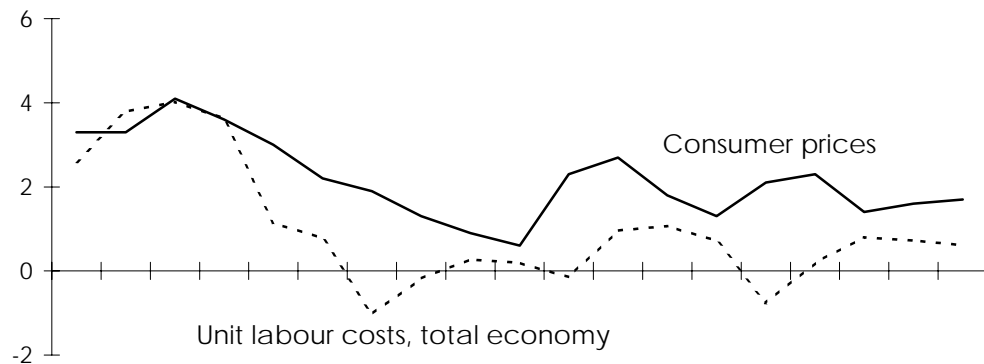
Consumption and income

Percentage changes from previous year, volume



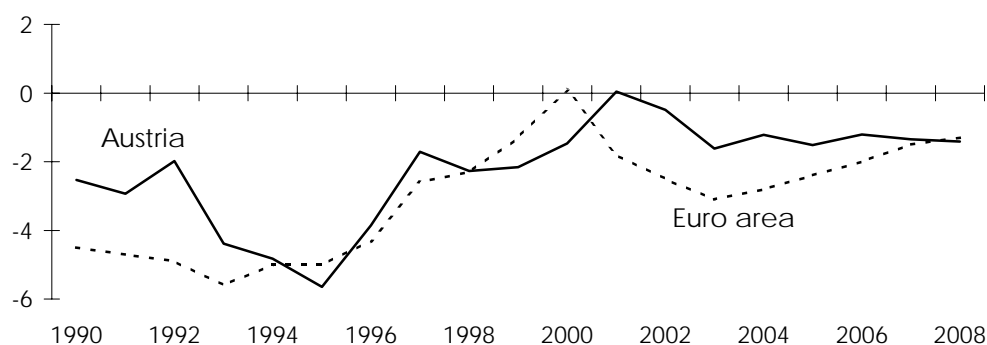
Inflation and unit labour costs

Percentage changes from previous year



General government financial balance

As a percentage of GDP



¹ Excluding parental leave, military service, and unemployed persons in training.

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