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# Austria's Economy Set to Grow Robustly Over the Medium Term

## Medium-term Forecast for the Years 2007 to 2011

**Real gross domestic product will grow on average by 2.5 percent per year in Austria from 2007 to 2011. Growth will be much higher than in the past six years during which it had been restrained by the sluggish European economy and slow domestic demand. The pace of medium-term growth is expected to accelerate in the euro area in the coming years, and in Austria, it will be even higher.**

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At +2.5 percent per year, Austria's economy will expand much faster until 2011 than had been expected up to now (+2.1 percent). Real GDP growth is much higher than during the period 2000 to 2006 (+1.7 percent), which was a phase of marked weakness of the European economy. The forecast for the years 2007 and 2008 are in line with the WIFO forecast of December 2006; medium-term trends were estimated for the subsequent years.

The recovery of the German economy for which signs are starting to appear will spread to the entire euro area, and the expansion chances in the new EU countries and accession countries will additionally boost growth. The high competitiveness of domestic exporting companies will enable them to benefit at an above average rate from this development. They are excellently positioned in Eastern Central Europe and Southeast Europe, and benefit in the euro area from the sustained attractive development of unit labour costs in manufacturing.

The economic upswing will also boost the investment activities of companies. Investments in machinery and equipment have practically stagnated since 2000, but now they will increase by 4 percent per year over the medium term. Residential construction, which during the period 2000 to 2006 had a dampening effect, has recovered. The high level of immigration and the growing scarcity on the housing market will heighten these developments. Private consumption will grow only slightly, but in the light of the high energy prices, especially car sales will remain flat. Net real income per capita will probably continue to rise moderately, with the increase in employment generally raising the disposable income of private households. It is assumed that the saving ratio of private households, which has increased substantially due to the insecurity on the labour market and the pension reform, will gradually decline again in the coming years.

The growth dynamic will help employment to widen substantially. However, as the supply of domestic and foreign labour is growing fast, the unemployment rate will decline only slightly. The number of employed persons will increase by almost 1 percent p.a., with the steepest rise being in part-time jobs. The unemployment rate will decline in 2007, but afterwards it will drop only slightly until the end of the forecast period to 6.2 percent (according to Public Employment service definition) in the year 2011. Additional measures for fighting unemployment and changes to the enti-

tlement period for childcare allowance announced by the government in its programme are not considered in these estimates.

The relatively high level of unemployment is still checking wage and price inflation. In the course of the forecast period, nominal and real per capita income will increase faster and the higher productivity gains will enlarge the scope for negotiating real wages. On average, the price of crude oil is estimated at almost \$ 63 per barrel for the forecast period. On this premise, price inflation will increase only slightly until 2011. The inflation rate will be around 1¼ percent on the average for the years 2007 to 2011.

Table 1: Main results

	Ø 1995-2000	Ø 2000-2006	Ø 2006-2011	2006	2007	2008	2009	2010	2011
	Year-to-year percentage changes								
Gross domestic product									
Volume	+ 2.9	+ 1.7	+ 2.5	+ 3.2	+ 2.7	+ 2.3	+ 2.5	+ 2.6	+ 2.6
Value	+ 3.7	+ 3.3	+ 3.9	+ 4.5	+ 4.4	+ 4.0	+ 3.7	+ 3.9	+ 3.8
Consumer prices	+ 1.4	+ 1.9	+ 1.7	+ 1.5	+ 1.6	+ 1.7	+ 1.7	+ 1.8	+ 1.8
Gross wages and salaries per employee <sup>1</sup>	+ 1.8	+ 2.0	+ 2.7	+ 2.8	+ 2.5	+ 2.5	+ 2.7	+ 3.0	+ 3.0
Persons in active employment <sup>2</sup>	+ 0.6	+ 0.6	+ 0.9	+ 1.7	+ 1.3	+ 0.7	+ 0.7	+ 0.9	+ 1.1
	Ø 1996-2000	Ø 2001-2006	Ø 2007-2011	2006	2007	2008	2009	2010	2011
	In percent								
Unemployment rate									
Eurostat definition <sup>3</sup>	4.2	4.5	4.5	4.8	4.6	4.5	4.5	4.4	4.3
National definition <sup>4</sup>	6.8	6.8	6.4	6.8	6.5	6.4	6.4	6.3	6.2
	As a percentage of GDP								
Net exports	0.8	4.2	4.9	5.2	5.1	5.0	4.8	4.7	4.7
General government financial balance (Maastricht definition)	- 2.3	- 1.0	- 1.1	- 1.2	- 1.3	- 1.4	- 1.2	- 0.9	- 0.5
	As a percentage of disposable income								
Household saving ratio	8.2	8.5	8.8	9.3	9.3	8.9	8.7	8.6	8.4

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

After the effects of the latest tax reform abate, the government deficits will steadily decrease. The medium-term development of the government budget cannot be estimated precisely, because there are no budget proposals at present and the Austrian stability programme only covers the period until 2008. Based on a rather restrictive assumption regarding government spending and in the light of the increase in government receipts, which are influenced heavily by economic growth, a decline of the deficit of the government budget to ½ percent of GDP is expected by 2011. The individual measures of the government's programme were not considered in the medium-term WIFO forecast, because there is only scant information available to quantify the measures. However, the forecast is based on the premise that economic measures will be taken during the forecast period – not least, inspired by the WIFO White Book (*Aiginger – Tichy – Walterskirchen, 2006*) – to improve the medium to long-term growth prospects.

Real GDP grew in Austria only slightly faster than the average of the euro area (+0.1 percentage point) in the years 2000 to 2006, but the advance in the years 2007 to 2011 is expected to rise to 0.2 percentage point. There are several factors that support this view:

- The weaker performance in Germany also had a negative effect on Austria's economy in the past decade. The brighter growth prospects in Germany should also help to boost Austria's economy – also in the tourism industry.
- Austrian companies are very well positioned in the fast growing economies of East Central Europe and in the EU accession countries of Southeast Europe.

- The competitiveness of Austria's economy with respect to prices –, as measured by unit labour costs, has improved immensely in the past decade. This development will continue and strengthen the exporting sector.
- Raising the spending ratio for research and development in Austria is expected to have a benign effect on the economy over the medium term.
- The government budgets of the major European economies are in great need of consolidation. Budgetary policy will be more restrictive in Germany, Italy and France than in Austria.
- The supply of domestic and foreign labour will continue to rise steeply in the coming years. This is supportive of the development of the economy and employment especially in those sectors with a scarcity of labour, but at the same time it lowers the chances of reducing unemployment among persons without high qualifications.

This medium-term forecast for Austria's economy for the years 2007 to 2011 is based on the short-term forecast made by WIFO in December 2006 for the years 2006 to 2008 (Scheiblecker, 2006). The calculations were done using the WIFO macro econometric model (Baumgartner – Breuss – Kaniowski, 2005) and are based on the assumptions regarding the international development of the economy by Schulmeister (2007). Therefore, we will only briefly outline the international developments of relevance for the forecast for Austria:

The impulses from foreign trade in the euro area will increase their impact on the domestic economy over the next ten years. After capacity utilisation among businesses attained the long-term average at the end of 2005 because of the sustained export boom, investment activity also livened up. Capacity utilisation in some EU countries is extraordinarily high even today, because investments in the future had been neglected for a long time. From the years 2007 to 2011, companies will invest much more than in the period 2000 to 2006.

**Positive impulses from the euro area and the new EU countries**

Table 2: International fundamentals

	Ø 1995-2000	Ø 2000-2006	Ø 2006-2011
	Year-to-year percentage changes		
Gross domestic product, volume			
Euro area	+ 2.7	+ 1.6	+ 2.3
23 OECD countries <sup>1</sup>	+ 3.0	+ 2.1	+ 2.6
	Ø 1996-2000	Ø 2001-2006	Ø 2007-2011
	Dollar per ECU or Euro		
Exchange rate	1.10	1.12	1.38
	Dollar per barrel		
Oil price: Average import price (cif) for OECD countries	19.5	37.9	62.8

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

Germany, Austria's most important trading partner, has largely overcome the high costs of re-unification, and a positive trend reversal is becoming apparent in the construction industry. Economic growth in Germany will lag behind that of the euro area only slightly in the coming years. After an economic dip in 2007 as a result of the hike in VAT, economic growth in Germany will accelerate.

The greatest risk for the further course of the economy in the euro area is the possibility that the investment boom will hardly spread to private consumption, because of the restraint in spending by private households motivated by the pension and healthcare reforms as well as unemployment. The development of crude oil prices and the exchange rate of the euro are other sources of uncertainty.

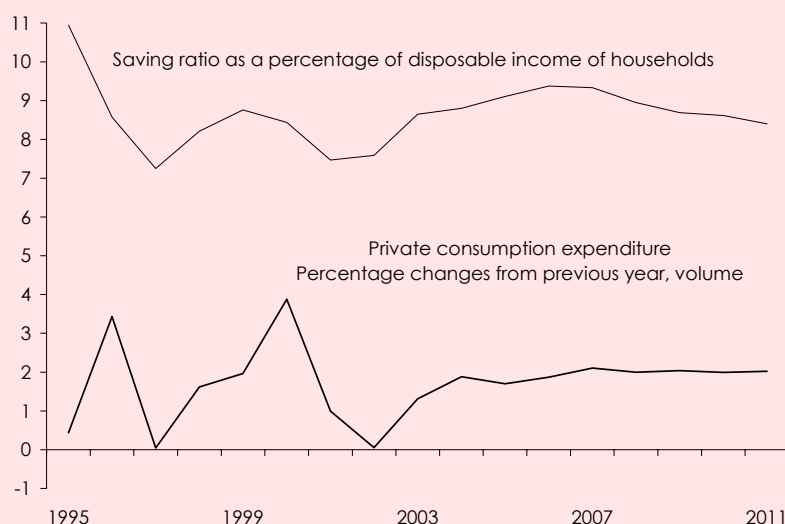
Positive impulses will come from the new EU countries of East Central Europe. This economic area is growing twice as fast as the euro area and imports there have

been gone up steeply. EU enlargement has accelerated growth in the new EU countries. Direct investments have become less risky, funds from the EU Structural Funds support the catching-up process and the pressure from competition is driving the progress in productivity.

Austria's economy will benefit from the recovery of demand from its major trade partners. Real exports are expected to rise in the years 2007 to 2011 by 6½ percent per year. Experience shows that an increase in the export of goods entails investments in machines, vehicles, and intangible goods. Investment activity has already started to pick up and will continue in the coming years.

### Higher growth forecast for Austria

Figure 1: Private consumption and saving ratio



Source: Statistics Austria, WIFO calculations.

Table 3: Components of aggregate demand, volume

	Ø 1995-2000	Ø 2000-2006	Ø 2006-2011	2006	2007	2008	2009	2010	2011
	Year-to-year percentage changes								
Consumption expenditure									
Private households <sup>1</sup>	+ 2.2	+ 1.3	+ 2.0	+ 1.9	+ 2.1	+ 2.0	+ 2.0	+ 2.0	+ 2.0
General government	+ 2.0	+ 1.1	+ 1.1	+ 1.5	+ 1.6	+ 1.6	+ 1.0	+ 0.7	+ 0.6
Gross fixed capital formation	+ 3.2	+ 0.7	+ 3.4	+ 5.2	+ 4.9	+ 3.4	+ 3.0	+ 2.9	+ 2.9
Machinery and equipment <sup>2</sup>	+ 7.0	+ 0.9	+ 4.2	+ 5.5	+ 6.5	+ 4.5	+ 3.3	+ 3.5	+ 3.2
Construction	+ 0.7	+ 0.5	+ 2.8	+ 5.0	+ 3.7	+ 2.5	+ 2.6	+ 2.5	+ 2.6
Domestic demand	+ 2.3	+ 1.0	+ 2.2	+ 2.3	+ 2.7	+ 2.3	+ 2.1	+ 2.0	+ 2.0
Exports	+ 8.2	+ 6.4	+ 6.5	+ 8.8	+ 7.1	+ 6.2	+ 6.2	+ 6.6	+ 6.6
Imports	+ 6.7	+ 5.3	+ 6.5	+ 7.6	+ 7.7	+ 6.6	+ 6.0	+ 6.0	+ 6.1
Gross domestic product	+ 2.9	+ 1.7	+ 2.5	+ 3.2	+ 2.7	+ 2.3	+ 2.5	+ 2.6	+ 2.6

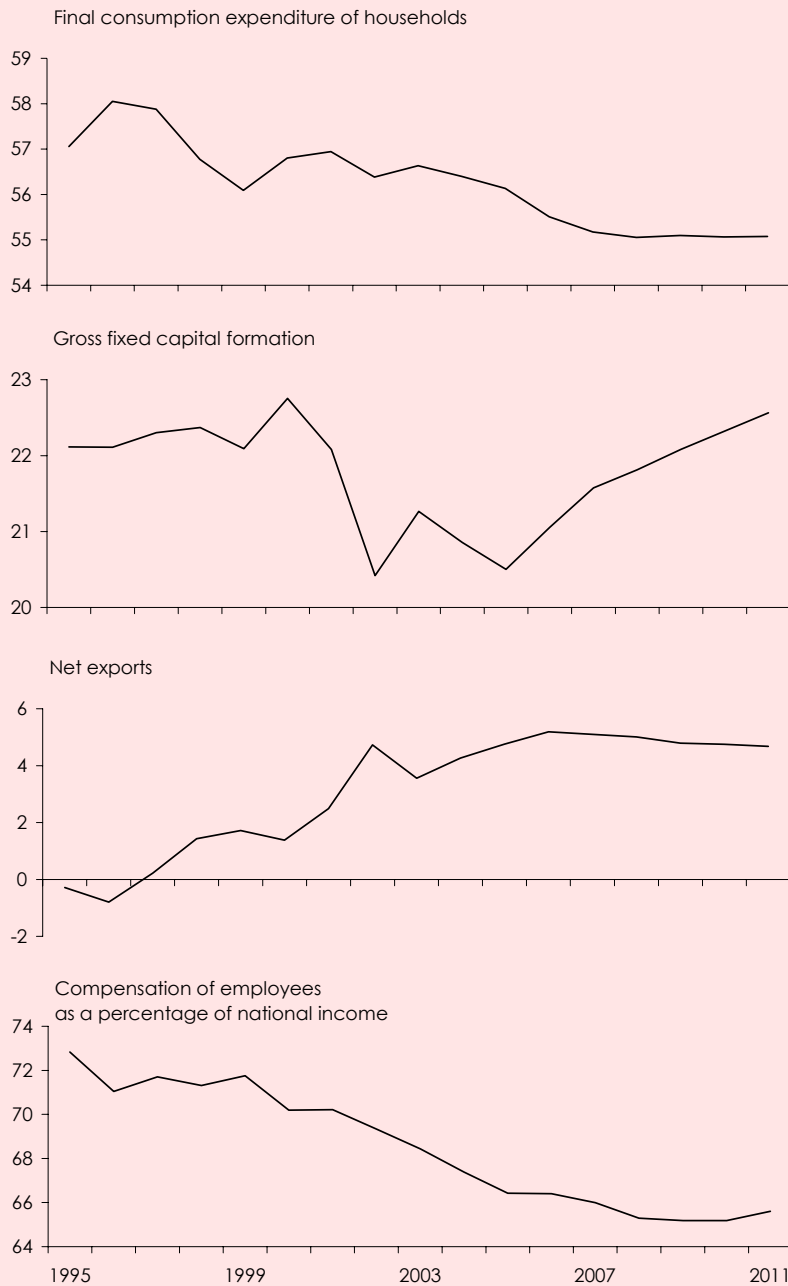
Source: Statistics Austria, WIFO calculations. – <sup>1</sup> Including private non-profit institutions serving households. – <sup>2</sup> Including other products.

When livelier investment activity triggers an increase in disposable real income through higher employment and productivity, this also boosts private consumption. Private consumption is expected to increase from 2007 to 2011 by 2 percent per year – much more than in the period 2000 to 2006 (+1.3 percent). This will happen on the condition that consumer confidence strengthens in the coming years and the saving ratio declines from its current high level (9.3 percent) to 2011 by 1 percentage point.

Demand for residential housing has been growing and the construction industry has overcome the slump of the past years; the high level of net immigration will contribute substantially to this trend. The growth in the sector of underground engineering (road and railroad construction) is expected to diminish over the forecast period due to the debts incurred by the government to finance the infrastructure investments of the past years.

Figure 2: Expenditure on GDP and income

As a percentage of GDP, at current prices



Source: Statistics Austria, WIFO calculations.

The medium-term growth forecast for Austria will be influenced strongly by the uncertainty prevailing over the course of the economy in the EU area in addition to the

developments in Eastern Central Europe. WIFO expects Austria's economy to grow by 0.2 percentage point more than the euro area<sup>1</sup>.

The government deficit was reduced substantially in the years 2001 to 2006, and on average it was around 1 percent of GDP (following 2.3 percent in the years 1996 to 2000); at the same time, the taxation ratio was lowered. In international comparison, the budget situation in Austria is relatively good. By contrast, there are a number of problems that will burden future developments: the high level of indebtedness of ASFINAG and ÖBB, the Eurofighter planes, the costs of leasing financing, etc.

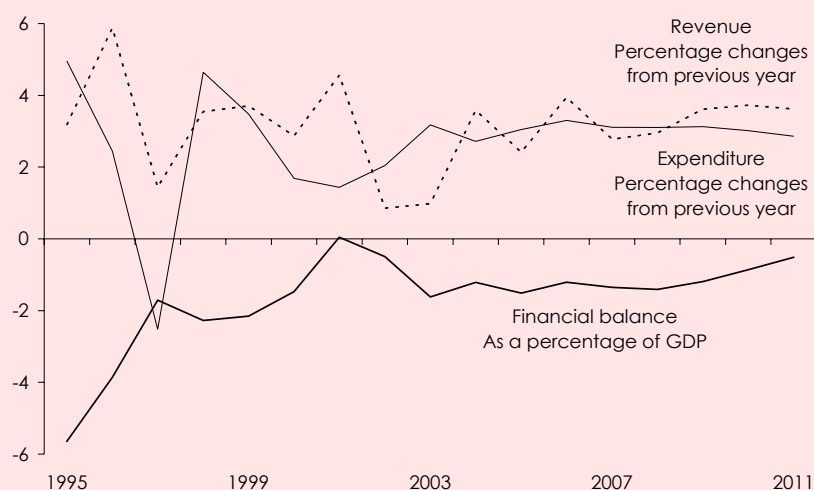
The government wants to achieve a balanced government budget by the year 2010. At the same time, forward-looking spending on education and research will be increased. The government programme has followed the growth strategy outlined in the WIFO White Book as regards the trends: promote research and development, as well as investment in education and infrastructure (Aiginger – Tichy – Walterskirchen, 2006). The financing of these forward-looking investments needs to be ensured by another reform of the public administration.

The government programme has not outlined any plans for lowering the ratio of taxes and charges to 40 percent by 2010. However, the programme states a reform of wage and income taxes by the end of the term of office. The goal formulated in the Austrian stability programme (Federal Ministry of Finance, 2005) of a balanced government budget by 2008 was too optimistic: The zero deficit will be achieved only later despite the excellent development of the economy. In addition to reducing interest payments on government debt, achieving a zero deficit would also mean having more room for anti-cyclical measures in recessionary phases or for lowering the tax ratio further. The latter – especially lower wage-related taxes – would have the purpose of enhancing the appeal of Austria as a business location.

## Balanced government budget is the goal

*The increase in tax revenues due to the improved economy will enable a reduction of the government deficit to around ½ percent of GDP in 2011 if spending restraint is exercised. To achieve a zero deficit, additional saving measures will become necessary or the next tax reform will have to be postponed.*

Figure 3: Revenue, expenditure and financial balance (according to Maastricht) of general government



Source: Statistics Austria, WIFO calculations.

We can only give a rough outline of the future development of government spending here, as there are no budget proposals yet for the years 2007 and 2008. The government programme defines new measures, which means additional spending, but it will only be possible to assess their impact on the economy and government budgets when the concrete terms and schedules become available.

<sup>1</sup> An additional risk factor for Austria's economy is the fact that the lack of snow could strongly affect winter tourism in the coming years (Smeral, 2007).

The forecast by WIFO assumes that the "Administrative Reform II" will be carried out rapidly, spending will increase moderately, and greater efficiency in the public sector will be achieved. As regards local authorities, deficits were reduced in the past decade, among other things, by the following: outsourcing services from the public sector, leasing-financed investments, shift in the promotion of residential construction from subsidies on annuity payments to loans, etc. Over the long term, these changes (especially leasing financing) could entail burdens that will make it more difficult for the Länder and municipalities to achieve their budget targets.

The borrowings by ASFINAG and ÖBB to finance the high volume of investments in road and railway infrastructure were an important instrument for containing the weakness of the economy in Austria in the past few years. The borrowings did not have any direct effect on the budget, but in the coming years, they will have to be covered by higher charges (tolls) and/or government subsidies.

Table 4: General government

At current prices

	Ø 1995-2000	Ø 2000-2006	Ø 2006-2011	2006	2007	2008	2009	2010	2011
	Year-to-year percentage changes								
Current revenue	+ 3.5	+ 2.7	+ 3.3	+ 3.9	+ 2.8	+ 3.0	+ 3.6	+ 3.7	+ 3.6
Current expenditure	+ 1.9	+ 2.6	+ 3.0	+ 3.3	+ 3.1	+ 3.1	+ 3.1	+ 3.0	+ 2.9
Gross domestic product	+ 3.7	+ 3.3	+ 3.9	+ 4.5	+ 4.4	+ 4.0	+ 3.7	+ 3.9	+ 3.8
	Ø 1996-2000	Ø 2001-2006	Ø 2007-2011	2006	2007	2008	2009	2010	2011
	As a percentage of GDP								
General government financial balance (Maastricht definition)	- 2.3	- 1.0	- 1.1	- 1.2	- 1.3	- 1.4	- 1.2	- 0.9	- 0.5

Source: Statistics Austria, WIFO calculations.

The development of receipts arises primarily from the dynamics of nominal GDP (and its components). Due to the increase in nominal private consumption, in wages and salaries, etc., a corresponding rise in receipts from value added tax and wage taxes is expected. The forecast does not assume any changes (with the exception of mineral oil tax) to tax rates or any tax reform. Under these conditions, the receipts of the state will probably grow at +3.3 percent p.a., which is considerably higher than during the period 2000 to 2006.

According to this forecast, which does not explicitly take the measures of the government's programme into account (with a few exceptions), the deficit of all public sector budgets will decrease to around ½ percent by 2011<sup>2</sup>. On the average of the period 2007 to 2011, the budget deficit will be 1.1 percent of GDP. Thus, it deviates from the target defined in the Stability and Growth Pact of maintaining a balanced budget throughout the business cycle.

Austria is also far from meeting the Kyoto targets for lowering greenhouse emissions. Over the long term, the purchase of emission certificates will require the spending of large volumes of public funds.

Unemployment in the past ten years was the central problem of economic and labour market policy. The unemployment rate (according to the Public Employment Service definition) was on average 6.8 percent for the years 1996 to 2006 and hit an unusually high level for Austria. During the period 2000 (5.8 percent) to 2006 (6.8 percent), unemployment rose by 1 percentage point.

The number of active employees has risen steeply since the year 2000 (+108,000), but the increase was mostly – with the exception of 2006 – in part-time jobs. In the

**Employment rising steeply, unemployment declining moderately**

<sup>2</sup> While the development of receipts at the given tax rates are largely endogenously determined from the WIFO model, on the spending side, exogenous assumptions were made that are oriented for the most part on the stability programme.

past five years, within the EU Austria has transformed from a laggard as regards part-time jobs into a country with an above average share of part-time jobs. Part-time jobs make it easier to combine family commitments and educational goals with employment. They also offer a number of benefits to companies: If the agreed-on working hours are exceeded, there is usually no overtime pay and no higher special bonus payments (13<sup>th</sup> and 14<sup>th</sup> salary), and in the case of irregular part-time employment, some sick days are at the expense of the dependent employees. The government programme contains a change to the overtime pay regime for part-time employees.

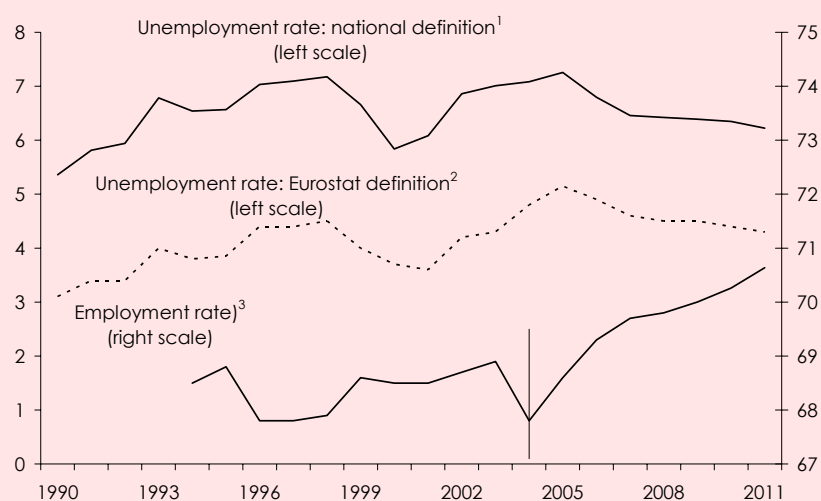
Table 5: Labour market, income

	Ø 1995-2000 <sup>1</sup>	Ø 2000-2006 <sup>1</sup>	Ø 2006-2011 <sup>1</sup>	2006	2007	2008	2009	2010	2011
	Year-to-year percentage changes								
Persons in active employment <sup>2</sup>	+ 0.6	+ 0.6	+ 0.9	+ 1.7	+ 1.3	+ 0.7	+ 0.7	+ 0.9	+ 1.1
Registered unemployed	- 2.1	+ 3.5	- 1.0	- 5.3	- 4.2	± 0.0	+ 0.2	+ 0.1	- 1.0
Unemployment rate									
Eurostat definition <sup>3</sup>	4.2	4.5	4.5	4.8	4.6	4.5	4.5	4.4	4.3
National definition <sup>4</sup>	6.8	6.8	6.4	6.8	6.5	6.4	6.4	6.3	6.2
Productivity <sup>5</sup>	+ 1.9	+ 1.4	+ 1.8	+ 2.0	+ 1.8	+ 1.9	+ 2.0	+ 1.9	+ 1.7
Gross wages and salaries <sup>6</sup>	+ 2.8	+ 2.7	+ 3.8	+ 4.6	+ 3.9	+ 3.2	+ 3.6	+ 4.0	+ 4.2
Per employee <sup>7</sup>	+ 1.8	+ 2.0	+ 2.7	+ 2.8	+ 2.5	+ 2.5	+ 2.7	+ 3.0	+ 3.0
Unit labour costs, total economy	- 0.2	+ 0.5	+ 0.9	+ 0.8	+ 0.7	+ 0.6	+ 0.7	+ 1.1	+ 1.3

Source: Federation of Austrian Social Security Institutions, Statistics Austria, WIFO calculations. – <sup>1</sup> Unemployment rate: Ø 1996-2000, Ø 2001-2006, Ø 2007-2011 – <sup>2</sup> Excluding parental leave, military service, and unemployed persons in training. – <sup>3</sup> According to Eurostat Labour Force Survey, percent of total labour force. – <sup>4</sup> According to Public Employment Service, percent of total labour force excluding self-employed. – <sup>5</sup> Real GDP per employment (dependent and self-employed according to National Accounts definition). – <sup>6</sup> Excluding employers' contributions. – <sup>7</sup> Employees according to National Accounts definition.

The labour market forecast for the next five years paints a positive picture of employment. The expected average real GDP growth rate of 2.5 percent per year would trigger an increase in employment by around 30,000 or almost 1 percent per year. The Lisbon goals with respect to employment will be achieved as regards total employment (70 percent) and for women (60 percent), but for older persons (50 percent) the target will be missed by a wide range. The increasing scarcity of skilled workers implies a higher effective retirement age.

Figure 4: Labour market trends



Source: Public Employment Service, WIFO calculations. – <sup>1</sup> As a percentage of total labour force exclusive self-employed; according to Public Employment Service. – <sup>2</sup> As a percentage of total labour force; according to Eurostat Labour Force Survey. – <sup>3</sup> Persons in employment as a percentage of population of working age (15 to 64); changed survey method since 2004.



The flexibilisation of the labour market will continue in the coming years: A discussion is underway of a prolongation of daily normal working hours and maximum working hours by two hours as well as extended shop opening hours.

The unemployment rate will continue to be a problem in the future and will require additional measures. According to the current forecast, the number of unemployed persons will persist at 230,000 until 2011. The unemployment rate will decrease only slightly: from 6.5 percent in 2007 to 6.2 percent in 2011. The average estimated for the period 2007 to 2011 is an unemployment rate of 6.4 percent of dependent employed persons and 4.5 percent of employed persons (inclusive self-employed) according to Eurostat. The measures of the new government to stimulate economic growth and to fight unemployment have not been taken into account here. On the other hand, the new childcare allowance regime will additionally raise the supply of labour and tend to make a reduction of unemployment harder. The target of the government of an unemployment rate of 4 percent by 2010 will not be attainable without additional measures (WIFO forecast for 2010: 4.4 percent).

Unemployment is persistent mainly because the supply of labour is rising fast due to immigration, a higher early retirement age and the increasing activity rate among women and the fact that unemployed persons generally seek full-time jobs. The high net immigration rate due to family reunification, asylum-seekers and foreign labour will continue in the coming years. The increase in foreign labour is made up to a large extent by persons who already have a residence permit in Austria, but no work permit.

Further reactions in the Austria labour market due to the EU enlargement 2004 will occur after the end of the transition periods when the full freedom of movement applies to labour from the new EU member countries. Up to now, the inflow of official labour from these countries has been kept low by transitional regulations. The European Commission is urging an end to the transition periods by 2009, but at the latest by 2011.

In the past ten years, with an average rate of 1¼ percent, inflation was very low; it fluctuated mainly with the crude oil and energy prices. There are many indicators that inflation will remain low in the coming years as well.

The most important determinants of future price developments are

- import prices, especially energy and crude oil prices,
- unit labour costs, and
- indirect taxes and fees.

Import prices play a major role for price inflation in an open economy with well developed foreign trade relations. Intense competition will become fiercer as a consequence of the globalisation and EU enlargement and will thus tend to dampen any rise of consumer prices. The primary risks are related to the development of crude oil and commodity prices, and exchange rate trends.

The forecast assumes that the crude oil price will only slightly increase from \$ 60 to \$ 65 per barrel in 2011. As crude oil prices are very volatile, these expectations are highly uncertain. By contrast, the development of import prices will continue to be kept low by cheap products and intermediate products from Asia (especially China) and Eastern Europe.

Based on these assumptions, there are no major inflation risks to the medium-term forecast. The inflation rate will remain low during the forecast period 2007 to 2011 at an average of 1.7 percent. This forecast is based on the assumption of easing pressure on energy markets, a relatively stable exchange rate and moderate wage increases.

The domestic determinants of inflation do not give rise to expectations of any noticeable price increase. Wage negotiation rounds will continue to be moderate in the light of the relatively high unemployment and the implied risk of relocation of

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**The inflation rate will stay below 2 percent**

companies (outsourcing) and will not cause any particular inflationary pressure. Moreover, the warning of the European Central Bank that it will tighten monetary policy in the event of "excessive" wage increases in the Euro area is still valid. Productivity growth will accelerate on average by ½ percentage point versus the period 2000 to 2006 on the back of the economic upswing and the increase in capacity utilisation, and will thus exert pressure on the development of the overall unit labour costs, which are the most important determinants of "home-made" price inflation. Around the end of the forecast period – after several relatively good economic years – unit labour costs are expected to rise a bit more strongly.

Table 6: Implicit price indices

	Ø 1995-2000	Ø 2000-2006	Ø 2006-2011	2006	2007	2008	2009	2010	2011
	Year-to-year percentage changes								
Private consumption	+ 1.4	+ 1.6	+ 1.7	+ 1.5	+ 1.6	+ 1.7	+ 1.6	+ 1.8	+ 1.8
Exports	+ 1.0	+ 1.1	+ 2.0	+ 2.4	+ 1.1	+ 0.7	+ 2.8	+ 2.7	+ 2.7
Imports	+ 1.6	+ 1.1	+ 2.6	+ 3.3	+ 1.1	+ 0.7	+ 3.9	+ 3.7	+ 3.7
Gross domestic product	+ 0.7	+ 1.6	+ 1.4	+ 1.3	+ 1.7	+ 1.7	+ 1.2	+ 1.3	+ 1.2

Source: Statistics Austria, WIFO calculations.

Nominal unit labour costs will increase during the forecast period by only around 1 percent per year. Real wages per capita will continue to rise more slowly than labour productivity. Thus, the trend of a declining wage share that started in the beginning of the 1980s is still underway. The decline of real unit labour costs (–0.8 percent p.a.) will continue to improve the international competitiveness of domestic companies, as long as the euro – as assumed in the forecast – appreciates only slightly. However, it also keeps domestic demand from rising.

In the past, measures to lower the budget deficit or to finance income tax cuts have included hikes in public fees and indirect taxes. According to the intentions of the new government, no wage or income tax cuts are planned before 2010. Whether or not indirect taxes (mineral oil tax, alcohol and tobacco tax), charges (motorway vignette, tolls, etc.) and taxes at municipal level will be raised to achieve the zero deficit targeted depends on future political decisions that can hardly be predicted. An increase in charges in the area of transport and possibly also of indirect taxes to cover the debts of ASFINAG should not be excluded.

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## References

## *Austria's Economy Set to Grow Robustly Over the Medium Term*

### *Medium-term Forecast for the Years 2007 to 2011 – Summary*

Growing at an annual rate of 2.5 percent until 2011, the Austrian economy will significantly outperform earlier growth expectations (+2.1 percent). The real increase of GDP will also be substantially above that of the period from 2000 to 2006 (+1.7 percent), a phase of distinctly sluggish economic performance in Europe. The forecast for 2007 and 2008 corresponds to the WIFO forecast of December 2006, while estimates of medium-term trends were used as a basis for the following years.

The beginning recovery of the German economy will affect the entire euro area; at the same time, the opportunities for growth in the new EU member states and the accession countries will generate additional economic momentum. Given their high level of competitiveness, Austrian exporters will derive an above-average benefit from these developments. They are particularly well-positioned to do business in Central and Eastern Europe as well as Southeast Europe, and they can take advantage of a consistently favourable development of unit labour costs in goods production.

The cyclical upswing also has an impact on private-sector investment. Having stagnated almost completely since 2000, investment in machinery and capital equipment will increase by 4 percent p.a. on a medium-term basis. Residential construction, which was holding back the pace of economic development in the 2000 to 2006 period, is recovering. High immigration figures and the increasing shortage of housing will reinforce this trend. Private consumption will rise at a moderate extent (+2 percent). A modest increase of real net per capita incomes is expected to continue in the coming years, while employment growth in general will lead to higher disposable incomes for private households. The saving ratio of private households, which had gone up significantly due to labour market insecurity and the impact of the pension reform, is expected to decline gradually over the coming years.

The dynamic performance of the economy will result in substantial employment growth. However, given the increase of both domestic and foreign labour supply, the unemployment rate is not expected to fall by any significant extent. The number of persons in employment will grow by almost 1 percent per year, mainly in the area of part-time work. After a drop in the number of unemployed in 2007, the unemployment rate will go down only slightly to 6.2 percent (according to Public Employment Service definition) by the end of the forecasting period in 2011.

The relatively high level of unemployment continues to have a restraining effect on wage and price inflation. In the course of the forecasting period, per capita incomes will gradually rise more rapidly both in real and nominal terms, with higher productivity increases widening the margin for real wage development. An average oil price close to \$ 63 per barrel is assumed over the forecasting period. Based on these assumptions, price inflation will only rise slightly until 2011. The average rate of inflation for the period from 2007 to 2011 will be 1.75 percent.

Once the effects of the most recent tax reform have worn off, the government budget deficit will shrink continuously. However, given the fact that budget proposals for 2007 and 2008 are not yet available, and that the Austrian stability programme only covers the period up to 2008, an estimate of the medium-term development of public expenditure includes a high degree of uncertainty. Assuming a rather restrictive government spending policy and a rise in government revenues – the latter largely as a result of economic growth – the government budget deficit is expected to drop to 0.5 percent of GDP by 2011. Most of the individual measures announced in the government programme of January 2007 have not been taken into consideration in WIFO's medium-term forecast, as the available information is not sufficient to quantify their impact.

While the rate of real GDP growth between 2000 and 2006 was only slightly above the average of the euro area (+0.1 percentage point), the difference is expected to increase to 0.2 percentage point in the period from 2007 to 2011.