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PRONOUNCED CYCLICAL DOWNTURN, RECOVERY NOT BEFORE MID-2002

ECONOMIC OUTLOOK FOR 2002 AND 2003

GDP in Austria expanded by no more than 1.1 percent in volume in 2001. The weakness in overall demand is set to continue until spring 2002 at least. By that time, a marked upturn in activity may set in, driven by a business cycle recovery in the USA and supported by low oil prices. On these assumptions, the Austrian economy may grow by 1.2 percent in 2002 and by 2.8 percent in the following year. The current sharp cyclical slowdown is putting strain on the labour market and on government budgets. Employment is expected to recede in 2002, making for a jump in the jobless rate to an average 6.6 percent. With automatic stabilisers operating, the general government balance in 2002 is projected at a deficit of around EUR 0.8 billion or 0.4 percent of GDP. Inflation is expected to decelerate significantly.

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In Austria, GDP edged down already in the third quarter 2001 from the previous period; according to the information available, it will decline further in the fourth quarter. Cyclical sluggishness is set to continue into early 2002, as indicators of business and consumer confidence are still clearly pointing downwards. Further into the year, however, a recovery can be expected to take hold. It will be driven mainly by the expected revival of the U.S. economy and by households and firms benefiting from lower energy prices. WIFO assumes that the lower turning point of the business cycle may be reached by the second quarter 2002, followed by a strong upturn in the second semester yielding year-on-year growth rates of GDP around 3 percent towards year-end.

The projected time profile of downturn and recovery implies modest annual growth rates for both 2001 and 2002. In 2001, GDP growth will average 1.1 percent in volume, owing to still lively activity early in the year. Nevertheless, this would be the lowest rate since 1993. With cyclical weakness likely to persist until late Spring 2002, the annual average rate of growth is unlikely to be much higher. If the upturn were to be delayed by only one quarter, GDP growth for the whole year 2002 could be lower by ½ percentage point than according to the present projections.

Both in 2000 and 2001, the Austrian economy grew by ½ percentage point less than the EU average. For 2002, a negative growth gap should again be expected. Still, growth will be stronger than in Germany, Austria's main trading partner, which holds the bottom rank among the EU countries. Overall GDP growth in the EU, projected at 1.5 percent, may about match the 1.6 percent expected for 2001. For Germany, the projections are for modest growth of 0.5 and 0.8 percent in 2001 and 2002, respectively. Economic policy in Europe bears a large part of responsibility for the extent of the slowdown which, admittedly, originated from developments in the USA and from high oil prices. For too long, policy trusted in overly optimistic growth scenarios, and too late it took action to stabilise activity via interest rate cuts and the readiness to deviate from its own budgetary targets.

Austrian exports may remain sluggish from autumn 2001 to spring 2002, as demand from major trading partners keeps slackening, while price competitiveness of domestic producers remains satisfactory. Weak foreign demand for goods is depressing growth in the manufacturing sector, which is projected at a modest 1½ percent, as much as in 2001. The poor outlook for sales is also responsible for a quasi-stagnation of investment in machinery, vehicles and electronic equipment. It will only be the cyclical upturn

in the second half of 2002 that will give fresh impetus to activity in these sectors which are highly dependent from developments in the world economy.

Table 1: Main results

		1998	1999	2000	2001	2002	2003
		Percentage changes from previous year					
GDP							
Volume		+ 3.5	+ 2.8	+ 3.0	+ 1.1	+ 1.2	+ 2.8
Value		+ 4.1	+ 3.5	+ 4.2	+ 2.9	+ 2.6	+ 4.1
Manufacturing ¹ , volume		+ 4.4	+ 3.4	+ 7.3	+ 1.8	+ 1.5	+ 5.0
Private consumption expenditure, volume		+ 2.8	+ 2.7	+ 2.5	+ 1.4	+ 1.6	+ 2.3
Gross fixed investment, volume		+ 3.4	+ 1.5	+ 5.1	- 0.5	+ 0.3	+ 4.2
Machinery and equipment ²		+ 6.4	+ 4.3	+ 11.1	+ 1.5	+ 1.8	+ 7.0
Construction		+ 1.3	- 0.7	+ 0.3	- 2.3	- 1.0	+ 1.5
Exports of goods ³							
Volume		+ 8.1	+ 7.7	+ 13.1	+ 5.0	+ 4.0	+ 8.5
Value		+ 8.4	+ 7.0	+ 15.6	+ 6.6	+ 4.5	+ 10.1
Imports of goods ³							
Volume		+ 7.1	+ 6.9	+ 10.9	+ 4.4	+ 3.0	+ 7.8
Value		+ 6.6	+ 6.7	+ 14.7	+ 6.5	+ 3.0	+ 10.2
Current balance	billion €	- 4.68	- 6.33	- 5.71	- 5.19	- 5.09	- 5.32
	billion ATS	- 64.5	- 87.1	- 78.6	- 71.4	- 70.0	- 73.2
As a percentage of GDP	in percent	- 2.5	- 3.2	- 2.8	- 2.5	- 2.4	- 2.4
Long-term interest rate ⁴	in percent	4.7	4.7	5.6	5.0	4.6	4.9
Consumer prices		+ 0.9	+ 0.6	+ 2.3	+ 2.7	+ 1.4	+ 1.6
Unemployment rate							
Percent of total labour force ⁵	in percent	4.5	3.9	3.7	3.9	4.2	4.0
Percent of dependent labour force ⁶	in percent	7.2	6.7	5.8	6.1	6.6	6.3
Dependent employment ⁷		+ 1.0	+ 1.2	+ 1.0	+ 0.4	- 0.2	+ 0.8
General government financial balance							
As a percentage of GDP	in percent	- 2.4	- 2.2	- 1.1	- 0.0	- 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.

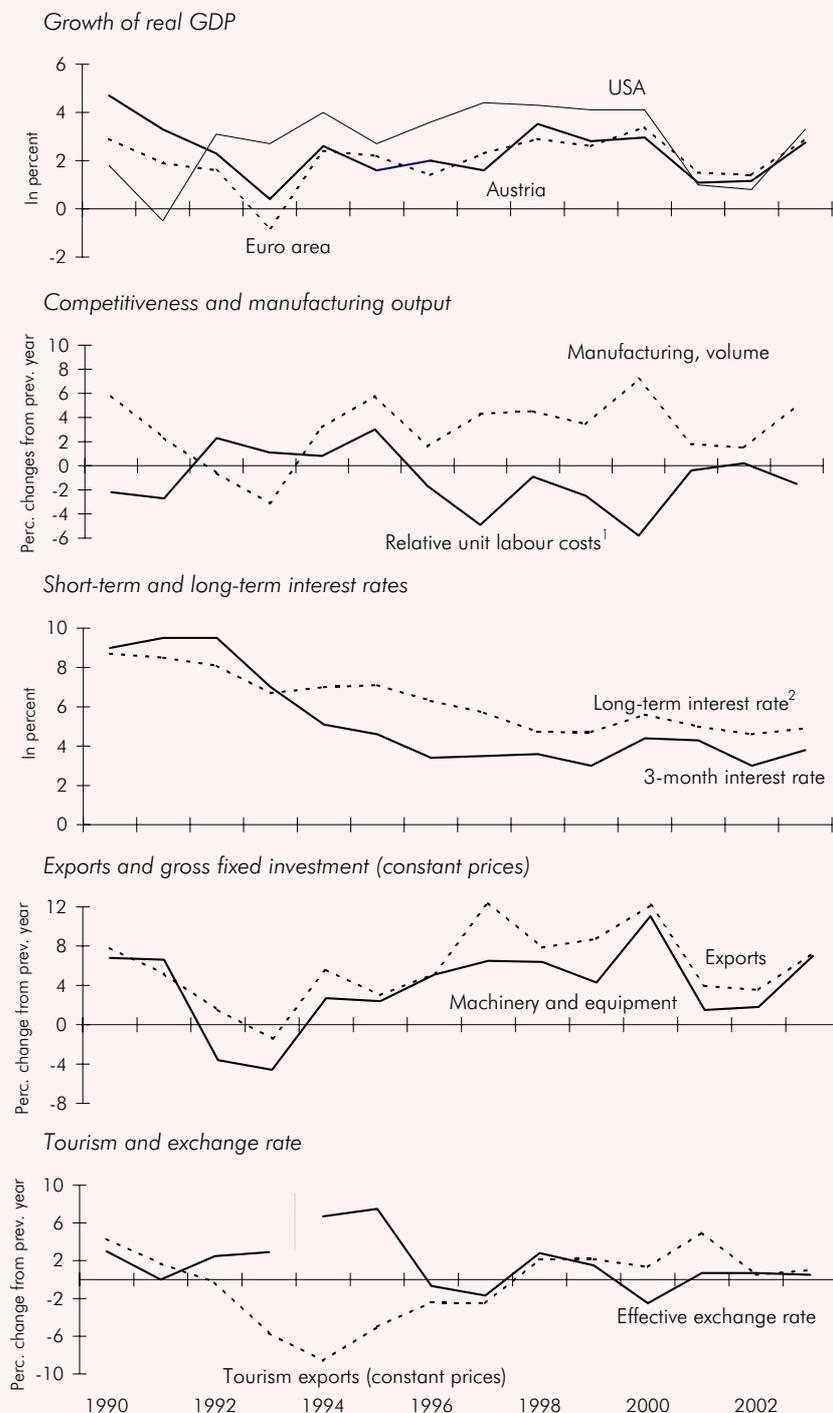
No major impulse should be expected from the domestic demand side. In the construction sector, output declined by 3 percent in 2001. It is likely to edge down by a further 1 percent in 2002, despite the "cyclical stimulus package" decided by the federal government, and stabilise only in the following year. While building of new structures is constrained by persisting over-capacities, a tentative recovery may be expected for road and railroad construction. Public consumption is shrinking in real terms. Spending by private households may rise by a further 1½ percent in 2002, despite only modest gains in real disposable income, implying a lower saving ratio. The rate of inflation, averaging 2.7 percent in 2001, was clearly higher than anticipated at the beginning of the year. With energy prices markedly lower and assuming an easing of food prices, headline inflation may abate to a rate of 1.4 percent in 2002.

The cyclical slackening has led to a significant reversal on the labour market. The number of dependent workers and employees could decrease by about 5,000 in 2002. Unemployment is set to rise strongly, by 19,000 to a projected average level of 221,000, corresponding to a ratio of 4.2 percent of the labour force (Eurostat definition) or 6.6 percent of the dependent labour supply. Jobs will be particularly scarce in the construction industry, in manufacturing and in the transport and telecommunication sector. Most severely affected will be the least qualified and foreign workers. While unemployment among older workers remains a key problem, it is hitting more and more also the young entrants to the labour force. Only on the assumption of a strong business cycle upturn will the labour market show signs of improvement by 2003, but even so the number of jobless will hardly fall below the mark of 200,000.

Advance tax payments on a large scale made for a balanced budget on the general government account for 2001. Nevertheless, the cyclical downturn is taking its toll also on public finances. Revenues from direct taxes are set to decline in 2002, while high unemployment will exert upward pressure on outlays. In its projections, WIFO is focusing on the impact the business cycle will have on the government balance. Issues which

are more of an accounting nature, such as the recognition by Eurostat of the dissociation of the federal real estate agency from the public sector, may, however, be of considerable influence for the actual general government balance. On present assumptions, the latter will be in deficit to the amount of € 0.8 billion or 0.4 percent of GDP. The business cycle recovery in prospect should, with the usual time lag, have a positive effect on the government balance. Thus, for 2003 a balanced general government budget is possible, assuming no revenue shortfalls from a tax reform that is currently under discussion.

Figure 1: International context



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

Although the "cyclical stimulus package" presented by the federal government in early December will not be able to counter the strong rise in unemployment in the current winter season, it should nevertheless prove useful in a more general context. The accent has been appropriately put on the promotion of research, on education and re-training (particularly in the construction sector), and on incentives for investment. Thus it should be possible to support activity in the short term and at the same time meet the longer-term requirements of structural adjustment. Priority should now be given to the speedy implementation of the package in order to secure its early effect on demand. In some areas, the measures should be made even more focused, in others they ought to be widened in scope. While their direct cyclical impact may remain limited, it is the stabilising effect of a pro-active policy stance on business and consumer expectations that is needed at the present juncture. In this regard, it is essential that the automatic budgetary stabilisers be allowed to operate to full extent.

In the USA, the National Bureau for Economic and Social Research has dated March 2001 as the onset of the current recession. After a stagnation in the second quarter, GDP fell by a seasonally-adjusted annualised rate of 1.1 percent in the subsequent period. Output in the manufacturing sector has lost 7 percent since autumn 2000. Machinery and equipment investment slumped, notably spending on information and communication technology which had largely contributed to the sustained expansion during the second half of the 1990s. Until recently, private consumption and demand for construction have supported overall activity, as has public expenditure.

While the events of 11 September have hit a number of sectors directly, such as the insurance industry and airline traffic, their major shock to the overall economy consists of rising insecurity and uncertainty. The latter is leading to further postponement of private spending on investment as well as durable consumer goods, thereby deepening the recession.

Leading indicators for the U.S. business cycle are giving mixed signals. Consumer confidence and the index of purchasing managers, while having picked up somewhat from their deep fall in September and October, still point to a contraction of GDP. Capacity utilisation in manufacturing industry weakened further in November, to a ratio 6 percentage points lower than a year earlier, the lowest mark since 1983. An early rebound in investment should therefore not be expected. Stock markets have overcome the reversal of last September/October and share prices are trending up again, owing largely to the pro-active policy pursued by the federal reserve. This is of major importance with regard to the further course of consumer spending. Retail sales are oscillating strongly, mainly reflecting car sales driven by large-scale rebates. Excluding the latter effect, sales have gone down recently. To what extent rising unemployment will impinge on households' propensity to consume, remains to be seen. On the other hand, the marked fall in oil prices is boosting household disposable income and should thus act as a stabilising force.

What is providing confidence at this moment, is the expansionary stance of economic policy. The Fed has massively cut short-term interest rates since early 2001. Most recently, the federal funds rate has been lowered to 1¾ percent. Negative short-term real interest rates and a steep yield curve should give major incentives to a cyclical upturn, as has been the case in the last recession of 1991-92. The measures of fiscal policy that have been announced should also produce stimulating effects on aggregate demand. Such effects would probably be greater if fiscal expansion took the form of higher expenditure rather than tax cuts. The general government balance will soon swing to a deficit.

The WIFO projections assume that the recession in the USA will soon be overcome. While GDP has probably fallen further in the fourth quarter 2001, the lower turning point may well be reached in the first quarter 2002. The subsequent upswing could be quite vigorous, given the favourable framework conditions. There may nevertheless be doubts about its sustainability: adjustments that will be necessary for the unwinding of two major macro-economic imbalances, namely the low private saving ratio and the high current account deficit, may put a brake on growth over the medium term.

Assuming a speedy recovery as from next spring, the U.S. economy may expand by ¾ percent in volume in 2002. For 2003, a rate of growth of 3¾ percent is projected.

Recession in the USA to be overcome in spring 2002

The U.S. economy has been in recession since the second quarter 2001. Leading indicators do not show a clear tendency. Despite a considerable margin of uncertainty it may be assumed that the economy will stage a cyclical recovery over the next months. Both monetary and fiscal policy are providing substantial stimulus.

Table 2: World economy

	1998	1999	2000	2001	2002	2003	
	Percentage changes from previous year						
<i>Real GDP</i>							
Total OECD	+ 2.4	+ 2.9	+ 3.4	+ 0.8	+ 1.0	+ 2.8	
USA	+ 4.3	+ 4.1	+ 4.1	+ 1.0	+ 0.8	+ 3.3	
Japan	- 1.1	+ 0.8	+ 1.5	- 1.0	- 0.5	+ 1.0	
EU	+ 2.9	+ 2.6	+ 3.4	+ 1.6	+ 1.5	+ 2.9	
Euro area	+ 2.9	+ 2.6	+ 3.4	+ 1.5	+ 1.4	+ 2.9	
Germany	+ 2.0	+ 1.8	+ 3.0	+ 0.5	+ 0.8	+ 2.5	
Central and Eastern Europe ¹	+ 3.5	+ 3.1	+ 3.9	+ 2.5	+ 2.3	+ 3.2	
<i>World trade, volume</i>							
OECD exports	+ 5.6	+ 6.2	+ 12.9	+ 0.3	+ 2.0	+ 8.8	
OECD imports	+ 5.5	+ 5.4	+ 12.0	- 0.3	+ 1.5	+ 8.0	
Intra-OECD trade	+ 8.3	+ 7.8	+ 11.6	- 1.0	+ 0.3	+ 6.8	
<i>Market growth²</i>							
	+ 11.3	+ 7.3	+ 13.3	+ 3.0	+ 3.0	+ 6.5	
<i>Primary commodity prices, in US\$</i>							
HWVA index, total, 1990 = 100	- 22.0	+ 12.0	+ 31.0	- 10.0	- 7.0	+ 11.0	
Excluding energy	- 13.0	- 8.0	+ 1.0	- 6.0	- 3.0	± 0.0	
<i>Crude oil prices</i>							
Average import price (cif) for OECD countries	US\$ per barrel	12.6	17.3	28.0	24.5	22.0	26.0
Exchange rate	US\$ per ECU or €	1.121	1.067	0.924	0.90	0.93	0.95

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

The recession in the USA is clouding economic conditions on the American continent as a whole. Particularly worrying is the situation in Argentina. Restrictive fiscal action and a hard currency policy prolonged an already deep crisis. In Japan, no signs of an end to the protracted recession are as yet discernible. Indeed, the outlook is for deflation continuing and activity weakening further in 2002, undermining growth prospects for all of South-East Asia.

Because of the synchronised slowdown in the world's major economic zones, growth of global trade has collapsed in 2001 and is set to pick up only gradually in 2002. A more lively expansion of the international exchange of goods and services may only be expected for 2003.

Crude oil has become considerably cheaper on world markets since last September. This is at variance with past experience from periods of international military escalation, and it does not correspond to the assumptions made in last September's WIFO projections. Key factors of recent oil price behaviour have been the cyclically-determined fall in oil demand which has not been offset by re-stocking and the failing implementation of targeted cuts in oil supply. The new projections assume that the average crude oil import price will remain close to the low \$ 20 per barrel until activity in the OECD area recovers in the first semester 2002, followed by an increase towards \$ 26 per barrel. The implicit improvement in the terms of trade should make a non-negligible contribution towards higher purchasing power and strengthening demand in the industrialised countries in 2002. World market quotations of other raw materials are also heading down under the impact of sluggish demand.

Over the last few quarters, activity in Europe has lost momentum to a considerably higher degree than anticipated by policymakers. GDP remained flat in the third quarter, and is expected to edge down in the year-end period. For the whole year 2001, economic growth may have been 1½ percent, less than half the rate attained in the previous year. Developments have been particularly unfavourable in Germany, where the economy is virtually in recession. France and Spain, where lively domestic demand is holding up against the adverse trend from abroad, appear to fare somewhat better.

Europe is proving more vulnerable to external developments than the European Commission, the Council and the ECB had believed with regard to the size of the internal market and the successful implementation of monetary union. Nevertheless, the cyclical reversal set in only a few months later than in the USA. Several transmission mechanisms have been at work, the most powerful of which has been foreign trade. The slackening

**European economy
substantially affected
by world-wide cyclical
downturn**

of extra-EU exports has dampened demand and output inside the single market. The rapid weakening of business sentiment led trans-national firms to cut their investment plans. In a world of global capital flows, negative confidence effects also played a role on European financial markets, although their impact on real economic activity is smaller than in the USA.

The slowdown in Europe would, however, have turned out much less sharp, had domestic demand not been inherently fragile. The restraint in investment following the excess spending on information and communication technology was observed also in Europe, though not to the same extent as in the USA. But the European economy was affected more strongly than the USA by the oil-price related terms-of-trade losses, due to the depreciation of the euro. In several EU countries, the construction sector is still being plagued by excess capacity. In addition, economic policy has a somewhat restrictive bias, notably fiscal policy as conducted by the member states.

European economic policy bears a large part of responsibility for the severity of the cyclical downturn. For too long, it has indulged in wishful optimism, not being ready, despite warnings to the contrary, to proceed to a realistic assessment and to take counter-action. As late as in spring and even summer 2001 there was talk of above-average economic growth in 2001 and 2002, notwithstanding the many signs of an abrupt slowdown. Cuts in interest rates and the readiness to let automatic budgetary stabilisers work and to tolerate deviations from adopted Stability programmes in support of income and employment, came far too late. Common European programmes of cyclical stabilisation, such as in the area of public infrastructure, are still missing.

All of these factors contributed towards dampening economic growth. Activity in Europe stagnated in the second half of 2001, yielding modest growth of clearly below 1 percent in a year-on-year comparison. Business and consumer confidence continue to weaken rapidly, as reflected by the surveys conducted by the European Commission. Thus, also the European economy is at the brink of recession.

Several factors point nevertheless to a recovery in the course of the year. The most important one is the – projected – upturn in the USA, which with the usual delay will stimulate activity in Europe. The fall in energy prices eases the cost burden for enterprises and households and will provide the much-needed boost to private demand. Fiscal policy may also act as a stabiliser for business activity, provided that budgetary consolidation and efforts to meet the targets of the Stability programmes are temporarily suspended. Likewise, under the assumption of further interest rate cuts by the ECB, as embodied in the projections, monetary conditions should be conducive to economic recovery. In such a scenario, European economic growth in 2002 may fall only slightly below last year's rate, followed by an acceleration to around 3 percent on annual average 2003. In any case, economic policy in Europe should be prepared to draw the appropriate lessons from its failures during the cyclical downturn.

Of particular concern is the economic situation in Germany. Activity was broadly flat in 2001, with GDP edging up by a mere ½ percent in volume. Key sectors of the German economy are highly dependent on developments abroad. In addition, there is the persistent slump in construction activity and an intriguing spending restraint on the part of consumers. With unemployment rising and economic policy having little scope for expansionary action, GDP growth in 2002 may again remain below 1 percent. In the following year, it should pick up to a rate of 2½ percent, provided that the world-wide cyclical upswing actually gets under way. Even so, growth would trail the European average by a wide margin, as it has done throughout the 1990s.

Stagnation in key foreign markets is also negatively affecting the countries in Central and Eastern Europe. Growth is slowing down markedly, to little more than 2 percent in both 2001 and 2002. The catching-up process of the transition economies is suffering a further setback, particularly in Poland. The new government is facing the difficult task of consolidating the deficit-ridden public finances, while meeting the challenges of economic reform and pressing social needs, all that under the auspices of a rather tight monetary policy conducted by the independent central bank.

The international cyclical slowdown has weakened the momentum of goods exports in the course of 2001. While an advance by around 10 percent year-on-year was recorded in the first quarter, the pace slowed to rates of 6 and 3¾ percent in the second and third quarter, respectively. Of late, weakness extended not only to exports to Japan and South-East Asia, but also to Central and Eastern Europe. While exports to North America also lost momentum, they still exceeded the year-earlier level last summer.

Early signs of a rapid cyclical slackening have not been taken sufficiently serious by economic policy in the EU. The lack of monetary and budgetary counter-action has added to the pace of the downturn. Incentives for a recovery may be expected from an upswing in the USA and from an improvement in the terms of trade following the fall in oil prices.

Stimulus from exports and manufacturing production lacking

Shipments to the EU single market exerted a stabilising influence, although demand from Germany for Austrian-made goods was virtually flat. Overall stagnation in exports should be expected for the fourth quarter. The sluggishness is entirely due to deficient external demand, as price competitiveness of Austrian goods is generally high, allowing sustained gains in market shares to be achieved.

Foreign trade will only recover with a revival of business activity in Europe. Thus, export sluggishness may well continue throughout the first semester 2002. For the whole year, merchandise exports may increase by 4 percent in volume (following a 5 percent gain in 2001), and accelerate to a pace of more than 8 percent in 2003.

Manufacturing net output is strongly determined by the strength of exports. Its advance was already subdued in the second and third quarter, while employment in manufacturing kept rising year-on-year. The WIFO business survey shows for the fourth quarter a further substantial weakening of the business climate, especially in the cyclically sensitive sectors of basic goods and technical manufactures production. A turnaround in business sentiment is not yet in sight. Production should remain subdued well into the first half of 2002. For the whole year, it may edge up by 1½ percent in volume, the same rate as for 2001, before accelerating to a projected 5 percent growth in 2003. Growth of labour productivity in 2001-02 will fall significantly below its long-term trend, partly because firms may be reluctant to lay off the more qualified parts of their workforce.

Corporate investment propensity has declined markedly as from mid-2001, according to the regular WIFO investment survey. Spending on machinery and business equipment is the cyclically most sensitive and confidence-driven component of overall demand. Lack of confidence in further developments of sales and profits will induce firms to defer planned investment projects. In 2001, investment in machinery, vehicles, electronics and software rose by a mere 1½ percent, and expectations for 2002 are for a similarly low rate of growth. The modest annual average rate masks, however, an implicit strong rebound in investment during the year, which is projected to continue throughout 2003 (+7 percent).

Because of weak demand from foreign trading partners, growth of merchandise exports is slowing down markedly. This, in turn, entails a slackening in manufacturing production. Likewise, investment in machinery and equipment may not resume until a revival of the international business cycle is confirmed. This should be the case by the second half of 2002.

Table 3: Productivity

	1998	1999	2000	2001	2002	2003
	Percentage changes from previous year					
<i>Total economy</i>						
Real GDP	+ 3.5	+ 2.8	+ 3.0	+ 1.1	+ 1.2	+ 2.8
Employment ¹	+ 0.7	+ 1.2	+ 0.5	+ 0.5	- 0.1	+ 0.9
Full-time equivalent	+ 0.8	+ 1.0	+ 1.3	+ 0.2	- 0.3	+ 0.6
Productivity (GDP per employment)	+ 2.8	+ 1.5	+ 2.5	+ 0.6	+ 1.2	+ 1.9
Full-time equivalent	+ 2.7	+ 1.8	+ 1.6	+ 0.8	+ 1.5	+ 2.1
<i>Manufacturing</i>						
Production ²	+ 4.5	+ 3.4	+ 7.2	+ 1.8	+ 1.5	+ 5.0
Employees ³	+ 0.1	- 0.7	+ 0.0	± 0.0	- 0.7	± 0.0
Productivity per hour	+ 4.3	+ 4.8	+ 7.3	+ 2.1	+ 2.5	+ 4.8
Working hours per day per employee ⁴	+ 0.1	- 0.6	- 0.1	- 0.3	- 0.3	+ 0.2

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

Merchandise imports rose by 4½ percent in volume in 2001, only slightly less than exports. Demand for imported primary goods weakened with slackening activity in the export-oriented sector of the economy. Broadly the same holds true for demand for durable consumer goods, a large part of which is imported from abroad. In the fourth quarter, the steep fall of crude oil prices on international markets also held down nominal imports. The deficit in the trade balance is set to exceed last year's figure of € 5.5 billion only slightly. With foreign trade growth probably subdued, some improvement is expected for 2002, primarily due to a fall in oil prices by around 10 percent on annual average.

The surplus in the tourism services balance has widened by around € 160 million in 2001. Gross receipts jumped by an inflation-adjusted 5 percent, the contribution of the hotel and restaurant sector to real GDP by 5½ percent, even if the number of overnight stays remained below the year-earlier level, notably in the summer season. In 2002, real output of the tourism sector is set to remain flat. The global cyclical weakness is dampening private spending in general, and the heightened political insecurity demand for

Current account deficit broadly unchanged

travel in particular. However, Austria as a safe destination may become more attractive for visitors, notably from within Europe, and also a larger part of domestic travel expenditure may remain in Austria.

The surplus on "other services" – including mainly cross-border transportation services – is rising steadily, a tendency that is set to continue with the closer integration of eastern Europe. The income and transfer balances, on the other hand, are in substantial deficit. In all, the negative gap in the current account may have totalled € 5.2 billion in 2001, slightly less than a year earlier, and corresponding to a ratio of 2½ percent of GDP. The prospects are for deficits of the same order of magnitude this year and next.

Construction output (value added) has been falling significantly since early 2001, remaining in volume 4 percent below the year-earlier level in the third quarter. Building of new homes continues receding particularly strongly, due to weak demand. Excess capacities have also emerged in the creation of office space. In road and railroad construction, financial resources were cut substantially from the previous year. However, for 2002, investment plans of the infrastructure investment societies (ASFINAG and SCHIG) provide for a marked increase in outlays.

The deep crisis in the construction sector is reflected by a slump in employment and a steep rise in unemployment. From January to November, the number of construction workers and employees fell by an average 10,600 or 4.1 percent year-on-year, the number of unemployed was by 7,400 or 30 percent higher in November than a year earlier. Most hit by unemployment are unqualified workers, among them many foreigners. The winter months are bound to see a further drastic increase in the jobless figure.

On annual average 2001, construction output has probably declined by around 3 percent in volume, as anticipated. Under the existing circumstances, 2002 may see only a partial recovery. Some relief should, however, be provided by the federal government's "cyclical stimulus package". Overall construction output may edge down by a further 1 percent, before heading up in 2003. While building construction may keep declining, investment in infrastructure should gain momentum and industrial building may pick up with the general business cycle upturn.

Developments in private disposable income of households were rather unfavourable in 2001. From the previous year, it fell by an average ½ percent in real terms, employees' net real per-capita earnings by even ¾ percent. Some improvement is expected for 2002. While the decline in employment will squeeze income, lower inflation and the absence of further tax increases should have a positive effect. Thus, disposable income may rise by 1 percent or more, net real earnings per employee by ½ percent.

In the past, households have tended to react to periods of cyclical weakness and budgetary retrenchment by lowering their saving as a proportion of disposable income. This is also the case in the present situation. In 2001, the households' savings ratio has probably declined by 1½ percentage points, allowing private consumption expenditure to rise by an inflation-adjusted 1½ percent despite the squeeze in real income. Nevertheless, spending on durable consumer goods was cut by 1½ percent, reflecting in part weak housing demand which also dampens purchases of household equipment, but also to some extent a more cautious attitude towards large-scale spending in a climate of heightened insecurity. New passenger car registrations from January to October were lower by almost 8 percent than in the year-earlier period.

In 2002, private consumption expenditure is projected to maintain a pace of 1½ percent real growth, implying a further slight reduction in the saving ratio. In 2003, the assumed strong recovery should boost disposable income mainly via higher employment figures. Assuming an average rise in per-capita earnings of 2½ percent and moderate inflation of 1.6 percent, disposable income may gain nearly 2½ percent. In that case, private consumption growth may accelerate to a rate of 2¼ percent, along with a rebound in the saving ratio.

The contribution of the trade sector to real GDP remained flat in 2001. While wholesale trade suffered from the international business cycle slowdown, retail trade (excluding food sales) held up rather well. The current year should see a small gain in net output of 1 percent for the whole sector, if the projections of a general recovery by the second semester and of steady growth of private consumption materialise.

Sustained fall in construction output

Employment in the construction sector is taking a sharp fall, and unemployment is rising drastically. The situation may worsen further in the coming months. Building construction is suffering from considerable over-capacities, while civil engineering may get some relief from higher public expenditure on infrastructure as from next spring. In spite of the "cyclical stimulus package", production is expected to ease further in 2002.

Private consumption acting as cyclical stabiliser

Consumer demand is once again exerting a stabilising influence on domestic business activity. Despite adverse income developments, private consumption is set to expand by an inflation-adjusted 1½ percent in both 2001 and 2002. Some acceleration, to a rate around 2¼ percent, may be expected for 2003, when a recovery should be firmly under way.

Table 4: Private consumption, earnings and prices

	1998	1999	2000	2001	2002	2003
	Percentage changes from previous year, volume					
Private consumption expenditure	+ 2.8	+ 2.7	+ 2.5	+ 1.4	+ 1.6	+ 2.3
Durables	+ 5.8	+ 9.4	+ 3.9	- 1.5	+ 1.5	+ 3.5
Non-durables and services	+ 2.3	+ 1.8	+ 2.3	+ 1.8	+ 1.6	+ 2.1
Household disposable income	+ 3.7	+ 1.7	+ 3.6	- 0.5	+ 1.1	+ 2.4
Household saving ratio						
As a percentage of disposable income	8.0	7.3	8.2	6.7	6.4	6.8
	Percentage changes from previous year					
Direct lending to domestic non-banks ¹	+ 3.7	+ 5.2	+ 6.7	+ 4.0	+ 4.6	+ 4.8
	In percent					
Inflation rate						
National	0.9	0.6	2.3	2.7	1.4	1.6
Harmonised	0.8	0.5	2.0	2.4	1.3	1.6
Core inflation ²	1.2	0.6	1.0	2.4	2.0	1.5

¹ End of period. – ² Excluding unprocessed food (meat, fish, fruits, vegetables) and energy items.

Table 5: Earnings and international competitiveness

	1998	1999	2000	2001	2002	2003
	Percentage changes from previous year					
Gross earnings per employee ¹	+ 3.0	+ 2.0	+ 2.5	+ 2.7	+ 2.5	+ 2.5
Full-time equivalent	+ 3.2	+ 2.4	+ 2.3	+ 3.0	+ 2.7	+ 2.8
Gross real earnings per employee	+ 2.5	+ 1.2	+ 1.0	+ 0.0	+ 1.1	+ 0.9
Net real earnings per employee	+ 2.3	+ 4.3	+ 1.7	- 0.7	+ 0.6	+ 0.4
Net wages and salaries	+ 3.3	+ 3.7	+ 4.3	+ 2.2	+ 2.4	+ 3.0
Unit labour costs						
Total economy	+ 0.2	+ 0.9	+ 0.6	+ 2.5	+ 0.9	+ 0.3
Manufacturing	- 1.7	- 1.5	- 5.1	+ 0.9	+ 0.5	- 1.7
Relative unit labour costs ²						
Vis-à-vis trading partners	- 0.9	- 2.5	- 5.8	- 0.4	+ 0.2	- 1.5
Vis-à-vis Germany	+ 0.4	- 0.1	- 2.4	- 0.1	± 0.0	- 1.7
Effective exchange rate – manufactures						
Nominal	+ 2.5	+ 0.6	- 2.7	+ 0.6	+ 0.5	+ 0.4
Real	+ 0.5	- 1.3	- 3.5	+ 0.2	- 0.2	± 0.0

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

In early December, the federal government adopted a "package" of measures designed to stem the danger of recession. The measures decided, will come too late to prevent unemployment from soaring in the winter season. On the whole, however, the measures envisaged are aiming in the right direction, providing incentives for research, education and re-training, and stimulating investment in strategic domains.

The present cyclical weakness may serve as an opportunity to push forward structural adjustment of the Austrian economy, if counter-cyclical measures take due account of major priorities over the longer term. A key requirement in this regard is the stepping-up of efforts in the area of research. The introduction of a premium for research outlays will from now on allow firms to benefit from public research promotion even in times when they make no profit. The most important measure in money terms is the follow-up financing facility of € 0.5 billion on top of the funds to be disbursed by the Board for research and technology policy. However, this measure will only take effect as from 2004. New efforts to raise venture capital and to facilitate the transfer of companies also concern areas deemed critical for achieving faster economic growth in Austria.

"Cyclical stimulus package" putting incentives in the right place

In the area of professional re-training, the establishment of a "work foundation" for the construction sector is particularly welcome. This kind of instrument has proved to be an effective tool of labour market policy in other sectors affected by structural change. In the construction industry, problems of labour qualification are particularly severe, due to the high proportion of unskilled workers. Nevertheless, as it stands, the new "work foundation" still appears inadequately funded, given the massive problems the sector has to cope with. As an additional measure, new types of short-time work for the construction sector may be tried, which ought to be combined with carefully-designed measures of professional upgrading and re-training.

The planned increase in the capacity of student entrants into professional higher education ("Fachhochschulen") as from autumn 2002 is welcome, as this type of schooling has proved to be a meaningful innovation in the domestic education system. At the same time, however, an increase in the supply of qualified teaching personnel has to be provided for.

Of relevance to the construction sector is an increase in the accelerated depreciation allowance, limited by the end of 2002, and the carrying-forward of building projects undertaken by the federal real estate agency. The federal states, for their part, have pledged to re-allocate resources earmarked for residential construction towards the renovation of old buildings. In view of the high labour-intensity of these activities, speedy implementation of these measures would be highly desirable. At the same time, a contribution would be made towards fulfilling the goals of climate protection as laid down in the Kyoto protocol.

The short-term impact of the "cyclical stimulus package" is likely to remain modest. Still, the package provides an important signal to investors and private households of a proactive approach to economic policy. Many observers have expressed their opinion that the measures have been adopted too late and may exert a pro-cyclical effect in the coming upswing. While it is true that economic policy has taken too much time to react, the risk of the essentially structural measures possibly having a pro-cyclical effect would seem minor against the very real danger of a further deepening of the current recession.

The most important instrument of counter-cyclical action, in terms of its effect on aggregate demand as well as towards stabilising expectations, are still the automatic budgetary stabilisers. Cyclically-induced shortfalls in tax revenues and increases in transfer payments must not be neutralised by restrictive discretionary fiscal action. This also implies that fiscal policy in 2002 should refrain from operating with conditional budget restrictions. A general government deficit resulting entirely from the business cycle reversal should be tolerated in the interest of the overall economic performance.

Money market interest rates have eased by 1½ percentage points in 2001 (as compared with -4¼ percentage points in the USA) to a present level of 3¼ percent, leading to a steeper yield curve. In view of sluggish activity and the likely deceleration of inflation, further interest rate cuts by the ECB may be expected. The WIFO projections assume that 3-months money market rates will not exceed 3 percent on annual average 2002, and that long-term government bond yields will be close to 4½ percent.

Financial market conditions have improved. Interest rates for commercial credit have been lowered by 1 percentage point since the beginning of 2001. For many small businesses, access to credit is becoming increasingly difficult. This could be related to banks' increased efforts to hedge against credit risks in the face of the present business cycle downturn. From a macro-economic perspective, however, this may turn out to be an obstacle to growth.

The rise in the consumer price index, while having slowed from the peak last May (+3.4 percent year-on-year), has still been 2.6 percent in October. Meanwhile, energy prices are clearly undershooting the year-earlier level: on a schilling basis, energy commodities were 35 percent cheaper in October than a year ago. Consumer prices for heating and electricity fell by 3 percent over the same period, transportation service prices edged up slightly. Overall inflation is nevertheless proving sticky. Food prices in particular are still moving up rapidly. Little relief is visible for the time being also for many services prices, and housing costs keep drifting up in spite of the existing supply overhang.

The average rate of inflation for 2001 is expected at 2.7 percent. In 2002, consumers should benefit mainly from lower energy prices. Moreover, food prices are assumed to

The "cyclical stimulus package" adopted by the federal government is providing incentives for structural development in the areas of education, research and investment. Any short-term cyclical effects are deemed to be modest. Automatic budgetary stabilisers will thus play a key role for the revival of economic activity.

Low interest rates, but problems of credit supply

Inflation decelerating only gradually

exert a dampening effect. Under these assumptions, inflation may abate to an average rate of 1.4 percent in 2002, with the Harmonised Consumer Price Index possibly showing a slightly lower increase of 1.3 percent. However, core inflation (excluding energy and unprocessed food items) is projected at 2 percent.

Employment growth has come to a halt towards end-2001. The number of full-time jobs, the bulk of which are held by men, is already heading downwards, whereas part-time jobs are still on the rise. Most affected by job losses is the crisis-ridden construction business, but also the transport and telecommunication sectors and public services. In these sectors, the job situation is set to weaken further over the months to come. As the international slowdown is becoming increasingly felt in domestic production, employment is likely to decline during 2002 also in manufacturing, where the trend remained upward-bound until last autumn. Sustained employment gains are recorded for business-related services and trade, although for both wholesale and retail trade such gains can be hardly explained by sales developments. The total number of workers and employees is set to decline in 2002, for the first time since 1993.

Fewer jobs, marked increase in unemployment in 2002

Table 6: Labour market

	1998	1999	2000	2001	2002	2003	
	Changes from previous year (in 1,000)						
<i>Demand for labour</i>							
Civilian employment	+ 22.1	+ 32.2	+ 27.7	+ 15.8	- 2.9	+ 26.3	
Excluding parental leave and military service	+ 30.8	+ 38.2	+ 30.8	+ 15.0	- 2.9	+ 26.3	
Dependent employment ¹	+ 21.1	+ 31.2	+ 25.8	+ 13.8	- 5.0	+ 24.0	
Excluding parental leave and military service	+ 29.8	+ 37.2	+ 28.9	+ 13.0	- 5.0	+ 24.0	
Percentage changes from previous year	+ 1.0	+ 1.2	+ 1.0	+ 0.4	- 0.2	+ 0.8	
Parental leave and military service ¹	- 8.7	- 6.0	- 3.1	+ 0.8	± 0.0	± 0.0	
Foreign workers	- 0.2	+ 7.8	+ 13.4	+ 9.1	+ 2.0	+ 14.0	
Self-employed ²	+ 1.0	+ 1.0	+ 1.9	+ 2.0	+ 2.1	+ 2.3	
<i>Labour supply</i>							
Economically active population	(15 to 64)	+ 11.0	+ 19.8	+ 25.2	+ 26.1	+ 22.9	+ 19.1
	(15 to 59)	+ 10.9	- 2.6	- 17.5	- 15.6	- 5.5	+ 3.1
Total labour force		+ 26.5	+ 16.2	+ 0.3	+ 24.2	+ 15.7	+ 18.3
Excluding parental leave and military service		+ 35.2	+ 22.2	+ 3.4	+ 23.4	+ 15.7	+ 18.3
Foreign		+ 0.7	+ 6.6	+ 12.0	+ 13.0	+ 7.0	+ 12.0
Migration of nationals		+ 3.9	+ 3.0	+ 1.0	± 0.0	± 0.0	± 0.0
Indigenous		+ 21.9	+ 6.6	- 12.7	+ 11.2	+ 8.7	+ 6.3
Excluding parental leave and military service		+ 30.6	+ 12.6	- 9.6	+ 10.4	+ 8.7	+ 6.3
<i>Surplus of labour</i>							
Registered unemployed ³	+ 4.4	- 16.1	- 27.4	+ 8.4	+ 18.6	- 8.0	
In 1,000	237.8	221.7	194.3	202.7	221.3	213.3	
<i>Unemployment rate</i>							
Percent of total labour force ⁴	in percent	4.5	3.9	3.7	3.9	4.2	4.0
Percent of total labour force ³	in percent	6.5	6.0	5.3	5.4	5.9	5.7
Percent of dependent labour force ³	in percent	7.2	6.7	5.8	6.1	6.6	6.3
<i>Participation rate⁵</i>							
Excluding parental leave and military service ⁶	in percent	67.6	67.6	67.3	67.5	67.5	67.6
Employment rate ⁷	in percent	70.7	71.2	71.5	72.2	72.6	72.9
Excluding parental leave and military service ⁶	in percent	63.2	63.6	63.8	63.8	63.5	63.7
		66.1	66.9	67.7	68.2	68.2	68.7

¹ According to Federation of Austrian Social Security Institutions. – ² According to WIFO. – ³ According to Labour Market Service. – ⁴ According to Eurostat. – ⁵ Total labour force as a percentage of active population (aged 15 to 64). – ⁶ As a percentage of population aged 15 to 69. ⁷ Employment as a percentage of active population (aged 15 to 64).

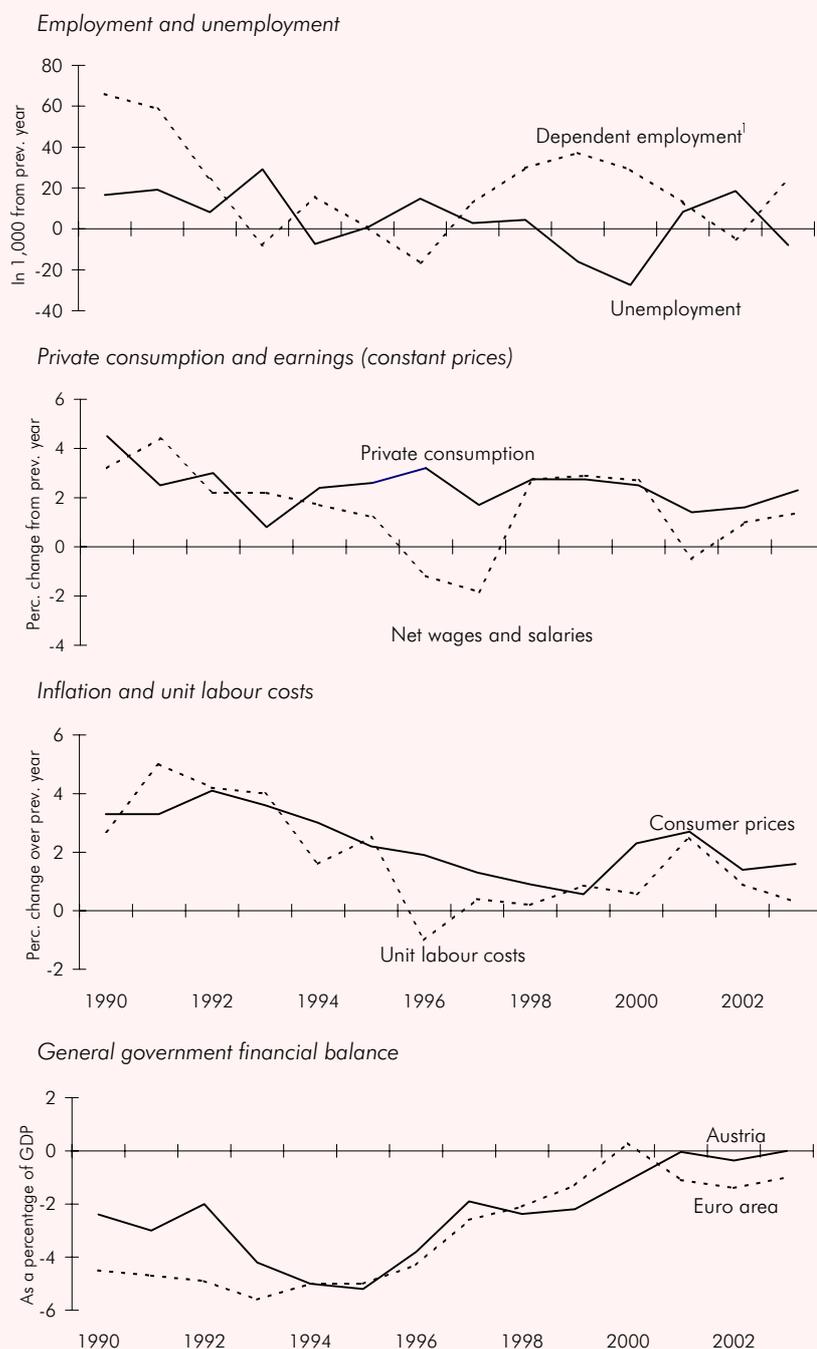
The number of unemployed exceeded the year-earlier level by 32,000 in November. For the winter months, further substantial increases should be expected in the construction and the manufacturing sector. Young workers are being increasingly affected, as for many of them the first entry into the labour market is via these two sectors. As in the past, the labour market reacts with a lag to the slackening of production. Both the fall in employment and the rise in unemployment are set to last well into 2002. Registered unemployment may be close to 220,000 on annual average, higher by almost 20,000 than in 2001, and corresponding to unemployment rates of 4.2 percent of the labour force (Eurostat definition) or 6.6 percent of the dependent workforce (conventional national calculation method).

Under the macro-economic conditions laid down in the projections, the labour market may only improve in 2003. With activity picking up, employment growth should resume,

The negative repercussions of the cyclical downturn are becoming increasingly visible on the labour market. In 2002, the number of dependent employees is expected to fall by 5,000, that of unemployed to rise by 19,000, compared with the year-earlier level. The situation is set to improve with a certain delay after the onset of the projected international recovery.

particularly in the service sector. In spite of an increase in labour supply, unemployment should come down somewhat, to an annual average around 213,000.

Figure 2: Economic performance



¹ Excluding parental leave and military service.

Owing to advance tax payments on a large scale, the public sector may have achieved overall budget balance already in 2001, notwithstanding the adverse budgetary consequences of slackening real and nominal growth. Such negative consequences will, partly because of the time lags involved, continue to be felt in 2002. Direct tax revenues are expected to recede. Weaker consumption and stagnant employment will dampen the yields from indirect taxes and social insurance contributions. On the expenditure side, the strong rise in unemployment will drive up related transfer payments.

Major challenges for budgetary policy

