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HIGH ECONOMIC GROWTH IN 1998, BUT INCREASING RISKS IN 1999

ECONOMIC OUTLOOK FOR 1998 AND 1999

The Austrian economy is expected to grow in 1998 by 3.3 percent, the highest growth rate since 1991. A vigorous expansion of exports and investment outlays form the basis of this dynamic development. Economic activity is set to slow down in 1999, however, as a result of the turbulence on the global financial markets. At 2.8 percent, GDP growth in Austria will nonetheless continue to exceed the medium-term trend.

At present, the world economy is being shaken by a deep crisis on the financial markets. The currencies of a number of emerging market economies have suffered massive losses, while other countries are faced with the threat of such devaluations. The impact of the financial turmoil on economic activity and, more importantly, the deep pessimism spreading among investors resulted in a plunge in most stock markets from a level mostly supported by a speculative frenzy. The search for safe havens made German bonds appear very attractive and brought about a loss in the value of the dollar vis-à-vis the convoy of the Euro currencies.

At the root of the financial crisis, which started in Asia, are political omissions, failed economic strategies, and speculative bubbles in the financial markets. The experience from earlier episodes of financial turmoil, especially after the stock market crash of October 1987, suggests that even a massive correction on the overheated equity markets need not have far-reaching consequences on economic activity. So far, the bear market in stocks in Europe and the USA did no more than offset the rise during the previous 12 months.

The stability of the world economy is also threatened by the recession in several emerging economies in Asia and Latin America as well as the deep crisis in Russia, which is spreading to neighboring countries. Another negative factor is Japan's persistent immobility in the political and economic sphere. These events darken the cyclical outlook for the economies of the USA and Europe as well.

All staff members of the Austrian Institute of Economic Research contribute to the Economic Outlook.

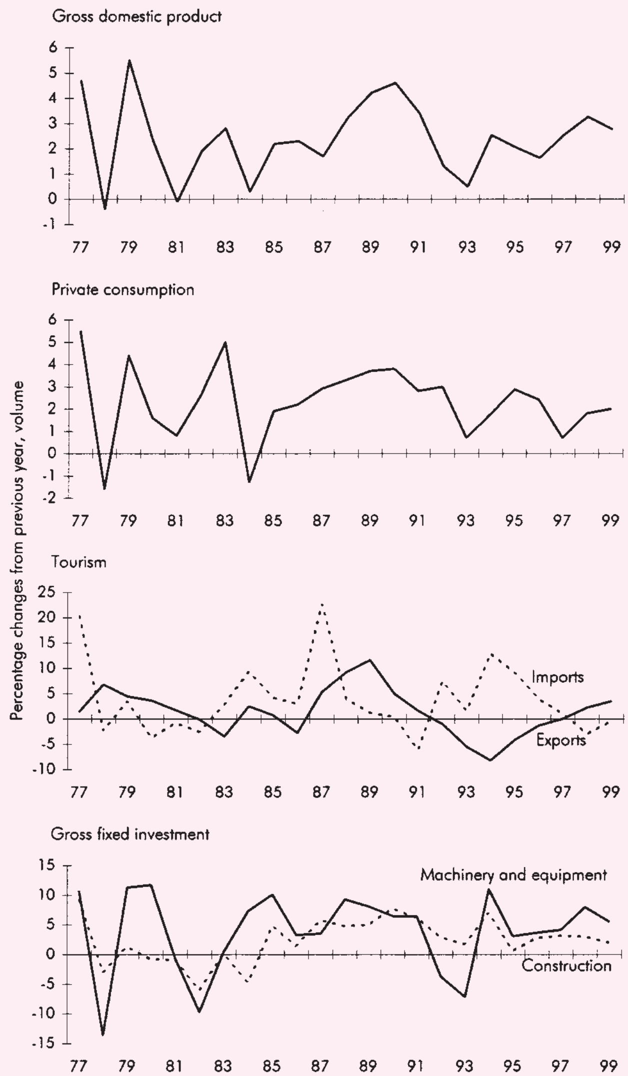
Table 1: Main results

		1995	1996	1997	1998	1999
		Percentage changes from previous year				
GDP						
Volume		+ 2.1	+ 1.6	+ 2.5	+ 3.3	+ 2.8
Value		+ 4.2	+ 3.7	+ 3.9	+ 4.6	+ 3.9
Manufacturing[1], volume		+ 1.0	+ 1.2	+ 4.3	+ 6.5	+ 4.0
Private consumption, volume		+ 2.9	+ 2.4	+ 0.7	+ 1.8	+ 2.0
Gross fixed investment, volume		+ 1.9	+ 2.4	+ 3.6	+ 5.3	+ 3.6
Machinery and equipment		+ 3.1	+ 3.7	+ 4.2	+ 8.0	+ 5.5
Construction		+ 0.6	+ 2.8	+ 3.2	+ 3.0	+ 2.0
Exports of goods[2]						
Volume		+ 12.1	+ 5.3	+ 15.3	+ 8.5	+ 7.0
Value		+ 13.2	+ 5.5	+ 16.8	+ 9.6	+ 8.1
Imports of goods[2]						
Volume		+ 5.7	+ 6.1	+ 9.2	+ 8.3	+ 7.0
Value		+ 6.2	+ 6.7	+ 10.9	+ 8.3	+ 8.1
Trade balance[2]	billion ATS	– 88.0	–100.6	– 75.2	– 72.3	– 78.1
Current balance	billion ATS	– 54.0	– 52.3	– 56.1	– 48.4	– 47.5
As a percentage of GDP	in percent	– 2.3	– 2.2	– 2.2	– 1.8	– 1.7
Long-term interest rate[3]	in percent	7.1	6.3	5.7	4.8	4.6
Consumer prices		+ 2.2	+ 1.9	+ 1.3	+ 1.0	+ 1.0
Unemployment rate						
Percent of total labor force[4]	in percent	3.9	4.3	4.4	4.5	4.4
Percent of dependent labor force[5]	in percent	6.6	7.0	7.1	7.2	7.0
Dependent employment[6]		+ 0.0	– 0.6	+ 0.4	+ 1.1	+ 0.9

[1] Value added, including mining and quarrying. – [2] According to Austrian Central Statistical Office. – [3] 10-year central government bonds (benchmark). – [4] According to Eurostat. – [5] According to labor exchange statistics. – [6] Excluding parental leave and military service.

Figure 1: Demand and output

Percentage changes from previous year, volume



Because of the relatively small importance of Russia's economy on the global plane and the moderate foreign trade links between Europe and the Asian region, the impact on the European economies has been minimal so far. The strength of the European economies stands in stark contrast to the gloomy picture projected by the global economy. In most EU member countries, particularly the continental ones, the current economic upswing has spread to investment and other components of domestic demand. Thus, the economic recovery has become mostly self-sustained.

During the last several months, economic activity in the EU has also benefited from the de-facto currency union and the concomitant exchange rate stability. The forces of integration within the single market, reinforced by the currency union, also help to stabilize economic activity. With an export rate of about 12 percent of the community GDP, the exposure of the Euro zone to foreign trade is much lower than for the individual member countries.

The unavoidable uncertainties surrounding the diagnosis of other crisis centers and the impact of the financial turmoil on economic activity suggest not only a downward revision of the projections for 1999, but also constitute a risk factor for these forecasts.

Economic growth in Austria will reach 3.3 percent in 1998, the highest rate since 1991. Growth projections for 1999, however, have to be reduced in accordance with international forecasts, but at a rate of 2.8 percent GDP growth will remain above the medium-term trend. In the EU economies as well, growth will not accelerate as was expected in the summer months, but fall short of the rate recorded for 1998 (+2¾ percent), reaching 2½ percent.

The impact of the financial turbulence on Europe will probably not be severe because the reduction in demand from the emerging markets has been partially offset by positive effects: prices of raw materials and of energy are on the decline, and interest rates are falling. Inflation has come to a virtual standstill.

As a result of the tremors shaking the global economy, the countries participating in the Economic and Monetary Union have come to be viewed as a safe haven for investors. With inflation below 2 percent, the Euro zone is a bastion of stability. Without a fixed schedule for achieving the single currency, recent events on the financial markets might have again forced a shift in exchange rate in Europe, with adverse effects on foreign trade.

Austria's economy is forecast to grow faster than the EU on average because its international competitive position has improved sharply during the last few years. In 1998, the economic recovery is mainly supported by buoyant merchandise exports and investment in machinery and equipment; in 1999, private consumption is forecast to contribute more to economic growth than in 1998. In the current year, the steep rise in the savings ratio is dampening consumer expenditures; though continuing in 1999, its depressing effect will be minimal.

For the first time since 1994, the unemployment rate will decline in the next year (from 4.5 to 4.4 percent). With the supply of labor rising exceptionally fast, the vigorous expansion in employment is not strong enough to lower unemployment in 1998.

As long as labor reserves, which have built up during several years of weak economic activity, continue to stream onto the labor market, it proves very difficult to cut unemployment. On the other hand, one third of the medium-term employment goal of the National Action Plan has already been attained in the first year of the five-year schedule.

WIFO's inflation forecast was sharply revised downwards mainly because of the plunge in prices of raw materials. In 1998 as well as in 1999, the inflation rate will reach a record low of 1 percent, and provide a solid basis for entering the Economic and Monetary Union at the beginning of 1999.

The general government deficit amounts to 2.2 percent in 1998 as well as in 1999. The draft budget of the Federal government is consistent with the revised WIFO projections, particularly because the strong upturn in 1998 will boost receipts from some taxes with a certain lag. Fiscal policy will have to remain on an austerity course in order to come closer to the target of a more or less balanced budget as required by the Stability Pact.

CRISES IN ASIA AND IN RUSSIA POSE INCREASING RISKS TO GLOBAL ECONOMY

Economic activity in 1998 has been overshadowed by a series of crises on the international financial markets. After the financial crisis in Asia, the crisis in Russia (which began in late summer) dampened the outlook for the global economy. The importance of Russia's economy for world trade is only twice as large as that of Austria's economy. Many observers fear, however, that the cumulated effect of the crises in Asia and in Russia might drag Latin America into turmoil.

In the EU economies, the economic upswing spread to domestic demand in the course of 1998, and thus became self-sustained. The financial crises in South-East Asia and in Russia as well as the turbulence on the international stock markets will probably slow down economic expansion, but are unlikely to force the economies off their growth path. Economic growth in the EU economies will not accelerate, but will slow down from 2¾ percent in 1998 to 2½ percent in 1999.

Most economists expect the financial crisis to result in lower economic growth but not in a recession. Financial analysts and investment bankers, on the other hand, reckon with severe consequences. The banking industry, among other sectors, is suffering greatly from the financial crisis and is being forced to make valuation adjustments of outstanding loans.

The process of rescuing and reorganizing the countries most affected by the crisis has been slower than expected. The recovery in the South-East Asian economies is being hampered by Japan's inability to find a way out of the recession. In Russia, the establishment of sound economic institutions and of a functioning legal system is seen as the major prerequisite to the proper working of the market mechanism. The strategy of providing IMF funds, of liberalizing capital flows, and of pushing up interest rates has failed. Capital and foreign exchange controls appear unavoidable at the present stage of Russia's development.

The financial turmoil has hit Japan powerfully; the recessionary tendencies have been strengthened over the last few months. Japan's gross domestic product is expected to contract by about 2 percent in 1998, and is unlikely to regain the 1997 level in 1999. Rescue operations for ailing banks require large public funds.

In the first half of 1998, the U.S. economy expanded by nearly 4 percent on a year-on-year basis, almost as fast as in the previous year. In the second quarter, economic growth slowed down only slightly, despite a strike at General Motors. The manufacturing sector, which usually reacts early on to cyclical changes, recorded a marked deceleration which first appeared in exports.

Table 2: World economy

		1995	1996	1997	1998	1999
		Percentage changes from previous year				
Real GDP						
Total OECD		+ 2.2	+ 2.7	+ 2.9	+ 2.0	+ 2.0
USA		+ 2.0	+ 2.8	+ 3.8	+ 3.3	+ 1.8
Japan		+ 1.5	+ 3.9	+ 0.9	– 2.0	+ 1.0
EU		+ 2.5	+ 1.8	+ 2.6	+ 2.8	+ 2.5
Germany		+ 1.8	+ 1.4	+ 2.2	+ 2.5	+ 2.5
Eastern Europe		+ 5.4	+ 4.7	+ 4.9	+ 4.5	+ 4.0
World trade, volume		+ 9.5	+ 6.8	+ 9.8	+ 4.0	+ 5.0
OECD exports		+ 8.6	+ 6.3	+11.3	+ 4.5	+ 5.0
Intra-OECD trade		+ 5.5	+ 6.0	+11.7	+ 7.0	+ 7.0
Market growth[1]		+ 6.1	+ 6.2	+ 9.4	+ 7.7	+ 6.2
Primary commodity prices, in USD						
HWWA index, total		+10.0	+ 3.0	– 2.0	–22.0	+ 5.0
Excluding energy		+11.0	– 9.0	+ 0.0	–15.0	+ 3.0
Crude oil prices						
Average import price (cif) for OECD countries	USD/barrel	17.2	20.6	19.1	13.5	14.5
Exchange rate	ATS/USD	10.08	10.59	12.20	12.40	11.70

[1] Real import growth of trading partners weighted by Austrian export shares.

As many people in North America own stocks, the plunge in stock prices may lower consumer expenditures. The recent decline in the consumer confidence index may indicate such a development. The turmoil on the financial markets could also unsettle investors and reinforce the downturn in economic activity. Thus, a marked deceleration of U.S. growth is expected for 1999, which will also reduce the pace of economic activity in Europe.

In Europe, with domestic demand expanding strongly, the economies proved rather robust in the face of the turbulence on the financial markets. In the first half of the year, economic growth in the EU averaged 2.7 percent. The slowdown in the second quarter reflects mainly special effects in Germany, fewer working days, and the weakening of the expansion in the U.K.

Europe's foreign exchange markets have been spared major turmoil in the wake of the financial crises elsewhere. This does not mean, however, that the European economies will remain totally insulated: the crisis in Asia is affecting the European economies directly via exports, indirectly via the collapse of world commodity and oil prices, the deterioration in the business climate, and the downturn in the global economy.

The political turmoil in Russia has only a marginal direct impact on the world economy because of the small size of the Russian economy, but it presents the financial world with additional, cumulative problems and may dampen the investment climate in Europe by raising the risks of doing business with Russia.

In addition to lowering growth of the global economy, the financial crises have also depressed long-term interest rates in the industrial countries: the financial tremors made investors more aware of the risks inherent in investments in emerging market economies and triggered a flight into assets with a high credit rating. International investors withdrew capital on a large scale from the newly industrialized countries and invested these funds in the USA and Europe, thereby lowering interest rates.

In the first half of the year, the German economy expanded by 2.9 percent from the previous year, a marked acceleration compared to 1997 (+2.2 percent). The divergence in the results for the first two quarters (+4.3 and +1.7 percent) is mostly due to special effects: because of the rise in the value-added tax on 1 April, some purchases were shifted to the first quarter; furthermore, the first quarter had two more working days, the second quarter two working days less than in the comparable period of last year.

The long-awaited revival of investment activity in Germany has been reflected in the economic statistics since the beginning of the year. This has broadened the basis of the upswing considerably. In the first half of the year, exports and investment in machinery and equipment expanded by about 8½ percent on a year-on-year basis. With a rate of 1 percent, consumer expenditures remained a weak component of aggregate demand. The adverse development in the construction industry continued to dampen the overall economic performance.

The turbulence on the financial markets will impair the expansion of the German economy, directly as well as indirectly, particularly through the slowdown in Japan and the USA. According to the business survey by IFO, manufacturing enterprises in West Germany view the export potential outside of the EU with less optimism than in previous months, mainly because of the crises in Asia, Russia and Latin America. The DIW estimates that German exports to Asia might fall by one fifth in 1998. From the viewpoint of businesses in the German manufacturing sector, the direct consequences of the financial tremors are less of a threat than the devaluation in overseas markets.

During the last few weeks many observers have called for interest cuts to avert a global recession. The Federal Reserve Board reacted to the world-wide financial turbulence with a slight reduction in benchmark interest rates; the Bundesbank, however, did not follow this lead, because domestic demand in Europe has firmed in recent months. The one-sided interest rate reduction tends to lower the value of the dollar, but at the same time helps to reduce the dollar-denominated debt of the debtor countries.

The forecasts produced by the German economic research institutes range widely. GDP growth in Germany is unlikely to exceed the rate of 2½ percent.

NO SPECULATIVE WAVE BEFORE THE INTRODUCTION OF THE EURO

As a result of the tremors shaking the global economy, the countries participating in the Economic and Monetary Union have come to be viewed as a safe haven for investors. With inflation below 2 percent, the Euro zone is a bastion of stability.

The turmoil on the financial markets did indeed trigger a flight into assets denominated in German marks as well as raise the interest rate spread among the prospective participants of EMU. Speculative attacks on the currency union or on the date of the introduction of the Euro are considered futile and therefore were not launched. Without a fixed schedule for achieving the single currency, the European currencies might again have come under attack on the financial markets, resulting in exchange rate disruptions.

On 1 January 1999, the authority of conducting monetary policy in the currency union will be transferred to the European Central Bank, which will gear its policy towards all member countries. At present, money market interest rates differ significantly among the EMU countries: in Germany and Austria rates are just slightly above 3 percent, but around 5 percent in Italy and Ireland. In the two latter countries, a downward movement is expected during the last months of this year.

Beginning 1 January 1999, there will be only one money market interest rate; national monetary policy and movements in exchange rates will cease to exist.

WEAKER EXPORT GROWTH IN AUSTRIA

Vigorous growth in export markets and the improvement in price competitiveness allowed Austria's exports to continue on their steep upward path in the first half of the year. The development of foreign orders indicates a slowdown, however: the rate of increase leveled off continuously.

The direct impact of the crisis in Russia on exports is probably limited, because only 1½ percent of Austria's exports are destined for Russia. The crisis may, however, besides depressing bank earnings, impair the investment climate.

The recovery of domestic demand in the EU should give Austria's export sector another year of considerable market growth. Nonetheless, export growth is expected to slow down despite a further improvement in Austria's competitive position.

Since 1995 unit labor costs in Austria's manufacturing sector have declined by 10 percent vis-à-vis the major trading partners. This movement has offset the deterioration of the competitive position resulting from the massive revaluation of the schilling during the years from 1992 to 1995. Austria gained market shares in 1997 as well as in 1998. These successes of Austria's export sector suggest that the high level of production costs does not impair Austria's position as a location of production. In the past, high energy and telecommunications costs constituted a serious locational disadvantage; the situation is about to improve as the liberalization of the market for electricity in 1999 makes electricity cheaper for large industrial users.

MORE FAVORABLE TOURISM BALANCE HELPS TO IMPROVE CURRENT ACCOUNT BALANCE

The balance of payments statistics are presented in a new framework[1]. According to the new scheme, Austria's current account exhibits a higher deficit, which totaled ATS 56.1 billion in 1997, ATS 8½ billion higher than the figure according to the old scheme.

This year, the current account deficit is expected to decline to ATS 48½ billion. This reduction is mainly due to the good performance of the tourism sector; moreover, crude oil prices relieve the trade balance.

In contrast to previous years, tourism yielded markedly higher foreign exchange receipts than in 1997; at the same time, Austrian tourists spent less abroad. The surplus in the tourism account is likely to exceed the 1997 level by ATS 6½ billion. During the months from May to August, turnover in the tourism sector was 6¾ percent higher than in the comparable period of 1997. Receipts from international travel are expected to rise by at least 4 percent in 1998 and by at least 5 percent in 1999.

In 1998, tourism has benefited from the movements in exchange rates and the stable price level in Austria. In a regression analysis, a positive relation between the movement in exchange rates and real market shares can be established: a decline in relative prices of the Austrian tourism supply by 3 percent results in a market share gain of 2 percent in European tourism.

Next year, the deficit in the current account will probably decrease only slightly to ATS 47.5 billion. While price competitiveness will continue to rise, the shift in economic buoyancy to domestic demand will boost imports substan-

[1] The forecast is based on the quarterly accounting scheme according to the "accrual" principle. The most important changes are: reinvested profits from direct investment are entered on a gross basis; transfers of assets are excluded from the current account; all transactions linked to foreign trade are aggregated to "goods"; currency reserves are entered on the capital account.

Table 3: Productivity

	1995	1996	1997	1998	1999
	Percentage changes from previous year				
Total economy					
Real GDP	+2.1	+1.6	+2.5	+3.3	+2.8
Employment[1]	+0.2	–0.5	+0.4	+1.0	+0.8
Productivity (GDP per employment)	+1.9	+2.1	+2.2	+2.3	+1.9
Manufacturing					
Production[2]	.	+1.3	+4.6	+6.5	+4.0
Employees	.	–2.9	–1.4	+0.5	–0.5
Productivity per hour	.	+4.6	+5.9	+5.5	+4.5
Working hours per day for workers	.	–0.3	+0.2	+0.5	±0.0

[1] Dependent and self-employed according to National Accounts. – [2] Value added.

tially. The tourism sector might benefit from income gains in Germany in 1999.

BOOM IN MANUFACTURING

Manufacturing output expands rapidly (1998 +6½ percent) in the wake of the export boom. The investment cycle is in full swing. Some basic-goods industries are suffering, however, from the plunge in world commodity prices. Despite a pick-up in private consumption, the consumer goods industries recovered only slowly.

In the first half of 1998, the manufacturing sector showed impressive gains. Owing to strong domestic and foreign demand, production expanded by about 7½ percent on a year-on-year basis. According to business surveys, growth will level off in the second half of the year because of the decline in demand from overseas. For the whole year of 1998, a production gain of 6½ percent is forecast.

Measured in terms of exports and output, manufacturing was barely affected by the Asian crisis in the first half of the year, even though the basic-goods sector suffered from the plunge in world commodity prices. During this phase of the economic cycle economic buoyancy normally shifts from the basic-goods to the capital-goods sector; this shift was particularly pronounced in the current economic cycle.

The investment cycle was in full gear in the first half of the year and the machinery and transport vehicles industries (auto parts) fared well. The consumer-goods industry, on the other hand, is recovering only slowly despite an upturn in domestic consumption demand.

In the summer, before the onset of the Russian crisis, firms viewed the economic situation less optimistically than in the spring. The rise in inventories of finished products suggests that the demand increase has not kept up with the strong production gains. The rise in the number of firms expecting a drop in prices reflects the price decline in the basic-goods sector.

INVESTMENT GROWTH EXPECTED TO SLOW DOWN

Increases in sales and high profitability induced a solid expansion in investment in machinery and equipment; in 1998 the rate of increase may reach 8 percent in real terms, but data are sketchy in this area.

The WIFO investment test corroborates data indicating lively investment activity: many firms, particularly those in technical manufacturing and in the chemical industry, plan substantially higher investment outlays than in the previous year. In 1999, however, growth in capital spending is likely to slow down in tandem with the slowdown in merchandise exports and manufacturing output. The cyclical risks in conjunction with the risks generated by the financial turbulence may help to propagate a wait-and-see attitude among investors.

In 1998, investment in construction will increase strongly mainly owing to special factors: clement weather conditions in the winter months and the booming renovation and modernization business boost the level of construction put in place (+3 percent).

The various construction branches showed widely divergent developments: the renovation and modernization business fare very well because starting in the year 2000 the maintenance reserves for tenant-occupied houses will no longer be exempt from taxes. Structural engineering is recovering slowly from the cuts imposed last year, and the construction of new office buildings appears to be emerging from the recession.

The construction of residential housing (multi-unit structures), on the other hand, is weakening despite a generous flow of support funds. The pent-up demand has vanished, and rents charged for newly let apartments are on the decline. The reduction in residential housing construction to a "normal" level will depress activity in the construction industry in the next year as well.

PRIVATE CONSUMPTION ON THE INCREASE

The rise in disposable income (by 3 percent in real terms) provides considerable room for higher consumer spending, but the steep rise in the savings ratio has the effect of

Table 4: Private consumption

	1995	1996	1997	1998	1999
	Percentage changes from previous year, volume				
Private consumption	+ 2.9	+ 2.4	+ 0.7	+ 1.8	+ 2.0
Durables	+ 0.9	+ 8.0	– 2.3	+ 2.0	+ 2.5
Non-durables and services	+ 3.2	+ 1.6	+ 1.2	+ 1.8	+ 1.9
Net wages and salaries	+ 1.2	– 1.6	– 1.8	+ 1.5	+ 2.2
Household disposable income	+ 2.9	+ 0.7	– 0.1	+ 3.0	+ 2.5
	As a percentage of disposable income				
Household saving ratio	10.2	8.6	7.9	9.0	9.4

dampening consumer expenditures. After the hefty decline during the years of drastic budget consolidation and cuts in net real income, the savings ratio is about to reach the "normal" level again, i.e., the long-term average value. Thus, at 1.8 percent, growth of private consumption is much weaker than that of disposable income.

The hefty rise in the savings ratio is dampening spending by private households; in 1999, this effect will be minimal, as most of the gains in disposable income will be spent on consumer goods. Thus, consumer expenditures will play an important role in sustaining the current upswing.

Next year, the savings ratio will rise only slightly, and its depressing effect on consumption will be minimal. Given the slowdown in economic growth, disposable income will increase, however, at a slower pace than in 1998. As very few Austrians own shares, the plunge in stock market prices will have a marginal effect on private consumption. This component of aggregate demand is expected to rise by about 2 percent, with demand for consumer durables continuing to expand at an above-average rate.

The dampening effects emanating from the budgets of the public sector, which were so strong in 1996 and 1997, are barely felt anymore. In 1998, old-age pension payments were raised by 1.3 percent, and in 1999 the so-called family package will push up transfer payments.

INFLATION REMAINS AT A RECORD LOW

With a rate of 1 percent, inflation attained the lowest value since the 1950s. This favorable situation is likely to persist into next year; the downward revision was prompted by the plunge in world commodity and crude oil prices and the decline in the value of the dollar.

This year, the price of crude oil is USD 13.5 per barrel, 30 percent below the level of 1997; raw materials (excluding energy) are about 15 percent cheaper than in 1997.

Table 5: Earnings and international competitiveness

	1995	1996	1997	1998	1999
	Percentage changes from previous year				
Gross earnings per employee	+3.2	+1.7	+1.6	+2.2	+2.7
Gross real earnings per employee	+1.5	–0.8	–0.4	+1.2	+1.7
Net real earnings per employee	+0.5	–2.2	–2.4	+0.7	+1.1
Net wages and salaries	+2.7	+0.9	+0.1	+2.5	+3.2
Unit labor costs					
Total economy	+1.4	–0.5	–0.5	+0.0	+0.8
Manufacturing	–0.6	–1.0	–5.0	–4.0	–1.5
Relative unit labor costs[1]					
Vis-à-vis trading partners	+2.2	–2.2	–4.9	–2.8	–0.8
Vis-à-vis Germany	–0.2	–0.6	–0.6	–1.9	–0.9
Effective exchange rate – manufactures					
Nominal	+3.0	–1.2	–1.8	+0.6	+0.9
Real	+2.6	–1.5	–2.6	–0.5	–0.3

[1] Manufacturing, in a common currency; minus sign indicates improvement of competitiveness.

This hefty drop in prices is mainly due to the slump in worldwide demand for raw materials and energy in the wake of the Asian crisis.

The plunge in raw materials prices is increasingly being passed on to prices of manufactures, food stuff, and energy at the consumer price level. Another factor lowering inflation is the downward trend in housing rents. Only services, which are very labor-intensive, are expected to post a higher price increase.

During the last few years the movement in wages and salaries has also exerted downward pressure on price increases. The growth in gross real earnings in manufacturing has lagged behind productivity gains; as a result unit labor costs have been on a downward trend for five years (–4 percent in 1998). The fall in labor costs offset the deterioration in the competitive positions as a result of the rise in the value of the schilling during the years from 1992 to 1995, and helped to restore the competitiveness of the export sector.

Gross earnings per employee are likely to rise by 2.2 percent this year. If the rise in part-time employment is taken into account and wage increases are calculated on the basis of full-time employees, wage gains are somewhat higher. The continuation of the present recovery might again result in higher wage claims.

UNEMPLOYMENT SET TO DECLINE IN 1999 FOR THE FIRST TIME SINCE 1994

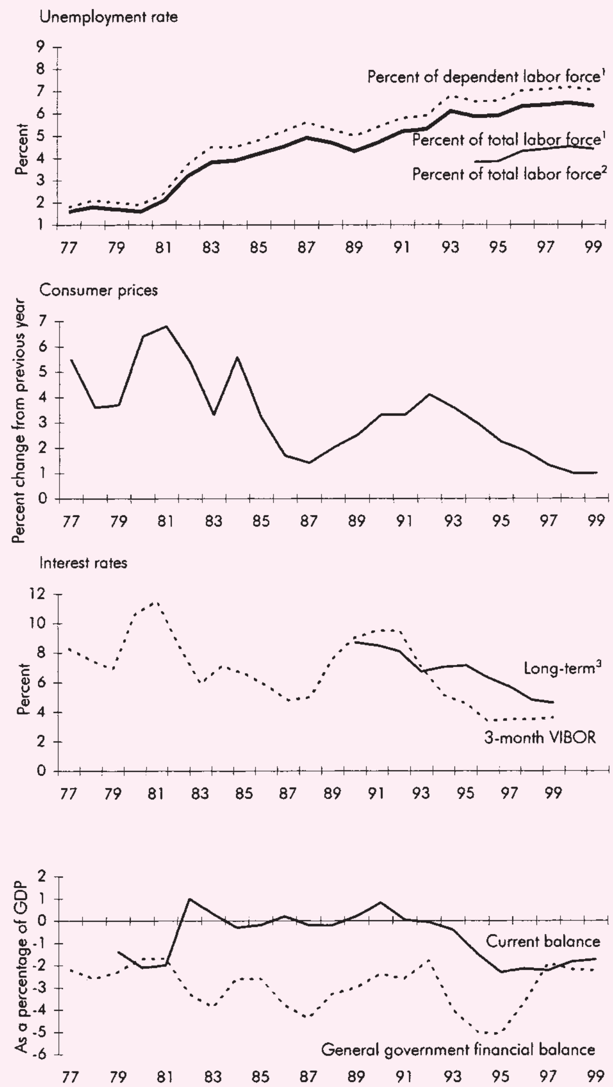
Demand for labor is rising markedly in the wake of the economic upturn. In 1998, employment is likely to exceed the level of 1997 by 32,000 or 1.1 percent. Even manufacturing has recorded employment gains since April: despite persistently high productivity increases the expansion in output requires additional labor.

Table 6: Labor market

		1995	1996	1997	1998	1999
		Changes from previous year, in 1,000				
Demand for labor						
Civilian employment		–12.3	–23.8	+ 8.8	+25.0	+25.0
Dependent employment[1]		– 2.5	–20.9	+ 8.3	+24.0	+24.0
Excluding parental leave and military service		+ 0.6	–16.5	+12.8	+32.0	+27.0
Percentage changes from previous year		+ 0.0	– 0.6	+ 0.4	+ 1.1	+ 0.9
Parental leave and military service[1]		– 3.2	– 4.4	– 4.4	– 8.0	– 3.0
Foreign workers[2]		+ 9.3	+ 0.0	– 1.6	– 0.5	± 0.0
Self-employed[3]		– 9.8	– 2.9	+ 0.5	+ 1.0	+ 1.0
Labor supply						
Total labor force		–11.6	– 9.0	+11.7	+30.0	+22.0
Foreign		+ 8.7	+ 2.8	– 1.7	+ 1.0	± 0.0
Migration of nationals		+ 5.6	+ 4.9	+ 5.4	+ 3.0	± 0.0
Indigenous		–25.9	–16.7	+ 8.0	+26.0	+22.0
Surplus of labor						
Registered unemployed[4]		+ 0.8	+14.8	+ 2.8	+ 5.0	– 3.0
In 1,000		215.7	230.5	233.3	238.3	235.3
Unemployment rate						
Percent of total labor force[5]	in percent	3.9	4.3	4.4	4.5	4.4
Percent of total labor force[4]	in percent	5.9	6.3	6.4	6.5	6.3
Percent of dependent labor force[4]	in percent	6.6	7.0	7.1	7.2	7.0
Participation rate[6]	in percent	67.5	67.2	67.2	67.7	67.9
Employment rate[7]	in percent	63.5	62.9	62.9	63.3	63.6

[1] According to Hauptverband der österreichischen Sozialversicherungsträger. – [2] Corrected for statistical breaks. – [3] According to WIFO. – [4] According to labor exchange statistics. – [5] According to Eurostat. – [6] Total labor force as a percentage of active population (aged 15 to 64). – [7] Employment as a percentage of active population (aged 15 to 64).

Figure 2: Main economic indicators



[1] According to labor exchange statistics. – [2] According to Eurostat. – [3] Yield of 10-year central government bonds (benchmark).

Most of the newly created jobs were filled with women from the "hidden reserves", who were unable to find a job during the years of sluggish growth. Many of these jobs are probably part-time jobs, as is indicated by the breakdown of employment gains by branches and the increasing gap between earnings for female and male employees. Many of the unemployed women are really looking for full-time jobs.

The current economic upswing has already had a strong impact on the labor market: more than 30,000 additional jobs were created during the last four quarters; employment expanded even in manufacturing. In the next year, the demand for labor, which usually lags behind output growth, should be sufficient to lower unemployment, an increase in labor supply notwithstanding.

In view of the stricter regulations concerning work contracting and precarious employment relations, a greater number of "normal" employment relations may have been registered, a change that is reflected in the statistics on the self-employed.

This year will see a further rise in the unemployment rate to 4.5 percent from 4.4 percent in 1997. The current increase in the number of jobless is also due to the discontinuance of special pre-retirement unemployment benefits (Sonderunterstützung) and the surge in labor supply. In 1998, the period during which parental leave benefits could be drawn was shortened to 1½ years, inducing many people to return to the labor market. In 1999, the rise in the labor supply will slow down to such an extent that the unemployment rate will decline slightly to 4.4 percent.

According to the National Action Plan for Employment, which was established in April 1998, the number of jobs is scheduled to rise by 100,000 by the year 2002, and the unemployment rate fall to 3½ percent of the total labor force. The focus of labor market policies are measures to reduce youth and long-term unemployment.

Table 7: Key policy indicators

	1995	1996	1997	1998	1999
	Billion ATS				
Fiscal policy					
Central government net balance	–117.9	– 89.4	– 67.2	– 67.3	– 70.1
	As a percentage of GDP				
Central government net balance	– 5.1	– 3.7	– 2.7	– 2.6	– 2.6
General government financial balance	– 5.1	– 3.7	– 1.9	– 2.2	– 2.2
	In percent				
Monetary policy					
3-month interest rate	4.6	3.4	3.5	3.5	3.6
Long-term interest rate[1]	7.1	6.3	5.7	4.8	4.6
Bond yield, average	6.5	5.3	4.8	4.5	4.3
	Percentage changes from previous year				
Effective exchange rate					
Nominal	+ 3.9	– 1.5	– 2.3	+ 0.6	+ 1.3
Real	+ 3.2	– 2.1	– 3.3	– 0.6	– 0.2

[1] 10-year central government bonds (benchmark).

One third of the medium-term employment goal of the National Action Plan has already been achieved. On the other hand, it proves very difficult to reduce unemployment as long as labor reserves, which have built up during several years of sluggish economic activity, continue to flow into the labor market.

BUDGET DEFICIT SLIGHTLY ABOVE 2 PERCENT OF GDP

According to the most recent data, the general government deficit totaled 1.9 percent of GDP in 1997. The surpluses attained by the provinces were higher than expected. This deficit ratio is slightly below the EU average (2.4 percent). In 1998 and 1999 the deficit of the public sector is likely to marginally exceed the mark of 2 percent of GDP, mainly because some special effects will no longer operate.

Austria's two austerity budgets have pushed the general government deficit below the mark of 3 percent of GDP required by the Maastricht Treaty. Nevertheless, the fiscal situation remains problematic. The goal of the Economic and Stability Pact, a more or less balanced budget, is still out of reach.

The development of the Federal budget during the course of 1998 was as expected. Whether or not the provinces and the municipalities will be able to achieve as high a surplus as in 1997 – under pressure to meet the Maastricht criteria – remains to be seen.

The draft budget for 1999 was already approved by Parliament; thus, it will hinge on the stringent administration of this budget whether or not, the goal of the budget can be actually attained. The draft budget for 1999 is compatible with the revised economic forecast by WIFO because the upturn in economic activity in 1998 will boost revenues from some taxes only with a certain lag.

In 2000 and thereafter, fiscal policy will face the task of holding firm against additional political claims and of pursuing a tight course in order to meet the budgetary targets of a balanced budget as imposed by the Stability Pact.

The tax reform of 2000 is scheduled to leave the budget deficit unaffected, and thus will be mainly a structural reform. The tax burden on the factor labor, which has increased significantly during the last decade, is set to be reduced, in order to stimulate demand for labor. The mode of financing this reform remains controversial and is the subject of discussion in the tax reform commission. As experience with earlier tax reforms shows, it is difficult to estimate the ramifications of such a reform and to stay within the pre-assigned fiscal limits.

Cut-off date: 30 September 1998