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## Economic Growth Dampened by Oil Price Hike, but Exceeding the Euro Area Average

### Economic Outlook for 2005 and 2006

**GDP growth will reach only 1.7 percent this year and is expected to move but to a marginally higher rate in 2006. The high energy prices are eating into real disposable income of private households and thereby into consumer demand. Latest survey results show an improvement in industrial confidence which may lead to a recovery in machinery and equipment investment from its low level. Higher public spending on infrastructure, research and the upgrading of qualifications of the labour force has led to a positive growth differential vis-à-vis the euro area, while at the same time widening the budget deficit somewhat further.**

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The Austrian economy has moved to a path of moderate growth. Real GDP rose by 0.4 percent seasonally adjusted in the second quarter from the previous period and may keep a similar pace throughout the second half of the year. Activity is held back mainly by the high costs of energy whose direct share in total consumer expenditure amounts to 7 percent. Their contribution to the increase in consumer prices is close to ½ percentage point. Assuming that the increase in energy prices will be passed on to other goods and services to such a moderate degree as so far, the rate of inflation will average 2.4 percent this year and 2.1 percent in 2006. Real disposable income of private households is growing by only around 1½ percent per year, allowing a gain in private consumption by 1.4 percent in real terms. Such an increase would be higher than last year, but undershoot the long-term average significantly for the fifth year in a row, undermining activity in the trade sector and in other services branches.

The export-oriented industrial sectors are growing faster than those parts of the economy depending mainly on domestic demand. Austrian exporting companies are proving highly competitive, boosting deliveries by a further 4.2 percent this year from the particularly successful performance in 2004, when export volumes jumped by 12.9 percent. Demand is growing notably from the oil-exporting countries whose foreign revenues have risen substantially. Incoming orders from the euro area are faring less well, given the lack of stimulus from internal demand. In the regular WIFO business survey, manufacturing firms have expressed continued uncertainty about the further trend in output, despite the latest improvement in business confidence. If such early signs for an industrial upturn are confirmed, the manufacturing sector may expect an increase in net value added by an inflation-adjusted 2.7 percent this year.

An increase in output and an improvement in medium-term expectations are prerequisites for a revival in machinery and equipment investment. With a projected decline of 1 percent in volume on annual average 2005, corporate investment spending has been subdued so far, despite an altogether comfortable profit situation. Since a large part of investment goods is supplied from abroad, notably machinery and vehicles, sluggish investment, in conjunction with weak consumer purchases of motor cars, is holding back merchandise import growth, projected at

1.7 percent in volume for 2005. For this reason, the trade balance is expected to be in small surplus, notwithstanding the high energy costs.

Since 1 May, 2005, the Federal government has adopted a set of measures designed to stimulate economic activity and rein back the marked rise in unemployment. Extra-budgetary funds for the improvement of transport infrastructure and expenditure for research were increased and budget allocations for active labour market policy reinforced. Public investment, in particular, should provide cyclical stimulus, mirrored by substantially higher order levels as reported by civil engineering companies. Since demand for residential construction is also strengthening, overall value added of the construction sector should expand by an inflation-adjusted 1.5 percent in 2005 and 2 percent in 2006.

<i>Main results</i>		2001	2002	2003	2004	2005	2006
		Percentage changes from previous year					
GDP							
Volume		+ 0.8	+ 1.0	+ 1.4	+ 2.4	+ 1.7	+ 1.8
Value		+ 2.6	+ 2.2	+ 2.8	+ 4.4	+ 3.5	+ 3.7
Manufacturing <sup>1</sup> , volume		+ 2.3	+ 0.4	- 0.1	+ 4.6	+ 2.7	+ 3.0
Whole sale and retail trade, volume		+ 2.0	+ 2.0	+ 0.3	+ 1.9	+ 1.2	+ 1.5
Private consumption expenditure, volume		+ 1.0	+ 0.3	+ 1.6	+ 0.8	+ 1.4	+ 1.7
Gross fixed investment, volume		- 1.5	- 5.0	+ 6.1	+ 0.6	+ 0.4	+ 2.4
Machinery and equipment <sup>2</sup>		+ 1.9	- 8.2	+ 7.7	+ 0.8	- 1.0	+ 3.0
Construction		- 4.2	- 2.3	+ 4.8	+ 0.5	+ 1.5	+ 2.0
Exports of goods <sup>3</sup>							
Volume		+ 6.3	+ 4.3	+ 2.6	+12.9	+ 4.2	+ 5.2
Value		+ 6.5	+ 4.2	+ 1.9	+13.9	+ 5.6	+ 6.0
Imports of goods <sup>3</sup>							
Volume		+ 5.5	+ 0.3	+ 6.5	+11.4	+ 1.7	+ 4.1
Value		+ 5.0	- 2.0	+ 5.0	+12.5	+ 4.6	+ 5.7
Current balance	billion €	- 4.13	+ 0.75	- 1.17	+ 0.75	+ 1.24	+ 1.07
As a percentage of GDP	%	- 1.9	+ 0.3	- 0.5	+ 0.3	+ 0.5	+ 0.4
Long-term interest rate <sup>4</sup>	%	5.1	5.0	4.2	4.2	3.4	3.6
Consumer prices		+ 2.7	+ 1.8	+ 1.3	+ 2.1	+ 2.4	+ 2.1
Unemployment rate							
Percent of total labour force <sup>5</sup>	%	3.6	4.2	4.3	4.8	5.1	5.1
Percent of dependent labour force <sup>6</sup>	%	6.1	6.9	7.0	7.1	7.2	7.2
Dependent employment <sup>7</sup>		+ 0.4	- 0.5	+ 0.2	+ 0.7	+ 0.9	+ 0.9
General government financial balance according to Maastricht definition							
As a percentage of GDP	%	+ 0.1	- 0.4	- 1.2	- 1.0	- 1.9	- 2.0

Source: WIFO Economic Outlook. – <sup>1</sup> Value added, including mining and quarrying. – <sup>2</sup> Including other products. – <sup>3</sup> According to Statistics Austria. – <sup>4</sup> 10-year central government bonds (benchmark). – <sup>5</sup> According to Eurostat Labour Force Survey. – <sup>6</sup> According to Labour Market Service, percent of total labour force excluding self employed. – <sup>7</sup> Excluding parental leave, military service, and unemployed persons in training.

In 2006, funds at the disposal of the labour market service for the upgrading of workers' qualifications and for facilitating labour market insertion have been stepped up by one-third. The focus is to be set on subsidies to women returning to the labour market and to young workers and jobseekers, i.e., those problem groups whose situation has deteriorated most during the last few years. WIFO expects that due to these measures a further increase in the unemployment rate in 2006 can be prevented. By then, the number of people out of work will have risen to more than 250,000, corresponding to an unemployment rate of 7.2 percent of the dependent labour force, or 5.1 percent of the total labour force on Eurostat definitions. The overall pattern on the labour market will remain unchanged, with employment heading up by around 1 percent in spite of economic growth remaining moderate, but labour supply increasing much faster than in the past.

The expansionary budgetary measures adopted since May 2005 should for the larger part become effective next year, with an estimated growth impulse of 0.3 percent of GDP. Owing to this impulse, the Austrian economy should grow slightly faster than the euro area average. At the same time, the additional government spending will lead to a somewhat higher budget deficit. The latter is projected at 2 percent of GDP for 2006, thereby exceeding the benchmark figure laid down in the Federal budget and in the Stability Programme.