

Markus Marterbauer

Business Cycle Upturn not in Sight

Economic Outlook for 2003 and 2004

In 2003, the economy will grow by only 0.7 percent. Under the current framework conditions of deficient overall demand in the euro area and a marked depreciation of the dollar vis-à-vis the euro, prospects of a cyclical rebound remain elusive even for 2004. With GDP growth projected at an annual average 1.2 percent, economic sluggishness may enter its fourth year.

All staff members of the Austrian Institute of Economic Research contribute to the Economic Outlook. Cut-off date: 25 June 2003. • E-Mail Address: Markus.Marterbauer@wifo.ac.at

In the first quarter 2003, the Austrian economy grew by only 0.5 percent year-on-year. The rise in domestic demand remained moderate, goods exports stagnated, and investment in machinery and equipment failed to reach the year-earlier level. At present, there are no signs for a recovery of business activity. For the whole year 2003, GDP growth is unlikely to exceed 0.7 percent.

Prospects for 2004 continue to be vague. A cyclical impulse would have to come from exports and investment, but the framework conditions are unfavourable, given the widespread lack of aggregate demand in the euro area. Consumers are holding back spending on durable goods, while firms postpone the implementation of investment projects in view of weak sales prospects. A revival of demand would require stimulus from policy action, but the latter is not in sight. The marked depreciation of the dollar vis-à-vis the euro is complicating matters further, as it implies losses of foreign market shares for European exports, a dampening of US demand for foreign goods and services, and a lower attractiveness of Europe as a target of foreign investment. The present projections are based upon the assumption of an exchange rate of 1.13 \$ per euro for 2003 and 1.16 \$ per euro for 2004.

Demand for Austrian export goods is weak, not only within the EU Single Market, but also in East-Central Europe, because of numerous setbacks in the catching-up process. By contrast, Austrian companies are highly successful on south-eastern European markets. The rise in the real-effective exchange rate by an estimated 3 percent in 2003 is weighing on competitiveness; since this cannot be compensated in the short run by the fall in unit labour costs in manufacturing, some losses of market shares should be expected. Growth of merchandise exports is decelerating markedly, to a projected volume rate of only 2.5 percent this year and little more in 2004 (+3¼ percent). Tourism is also suffering from the undermined confidence of European consumers: following the good results over the past two years, 2003 is likely to see a decline in real foreign gross earnings by 1 percent.

Domestic companies continue to hold back with capital spending. The investment ratio is falling markedly, from 24 percent of GDP in 2000 to 21½ percent in 2003. The main reason is the slump in spending on machinery and equipment, which fell by a total 13 percent in nominal terms over the last two years. In the face of poor capacity utilisation and subdued sales expectations, a rebound in business fixed investment should not be expected for 2003 and 2004 either. Such a rebound would, however, be crucial for stronger GDP growth and a turnaround on the labour market.

Production in manufacturing is likely to continue its stagnation in 2003, in the absence of stronger demand, with the number of industrial jobs falling sharply. In construction, however, there are signs of a tentative recovery, as output growth of 1½ percent in 2003 and 1¾ percent in 2004 could, for the first time since 1996, exceed that of overall GDP. Already since last summer, civil engineering has staged a recovery, owing to higher investment in road and railway infrastructure. The regular

WIFO business survey now points to an imminent pick-up also in the building sector, notably new-home construction.

Growth of real disposable income is firming somewhat vis-à-vis 2001 and 2002, due not only to lower inflation, but also to higher child-care and retirement benefits. Still, income gains will not be strong enough as to allow sizeable increases in private consumption. Household spending on durable consumer goods and travel may also be dampened by a rise in the saving ratio, which constitutes a considerable cyclical risk. The WIFO forecast assumes a slight increase in the saving ratio, from 7.5 percent of disposable income in 2002 to 8 percent in 2004, allowing real private consumption gains of 1.3 percent in 2003 and 1.6 percent in 2004, distinctly below the long-term average growth rate of 2¼ percent.

<i>Main results</i>		1999	2000	2001	2002	2003	2004
		Percentage changes from previous year					
GDP							
Volume		+ 2.7	+ 3.5	+ 0.7	+ 1.0	+ 0.7	+ 1.2
Value		+ 3.4	+ 5.0	+ 2.3	+ 2.2	+ 2.3	+ 2.7
Manufacturing ¹ , volume		+ 3.0	+ 6.5	+ 1.3	+ 0.3	+ 0.3	+ 1.8
Private consumption expenditure, volume		+ 2.3	+ 3.3	+ 1.5	+ 0.9	+ 1.3	+ 1.6
Gross fixed investment, volume		+ 2.1	+ 5.9	- 2.2	- 4.6	+ 0.8	+ 1.8
Machinery and equipment ²		+ 4.9	+11.8	- 2.9	- 9.4	± 0.0	+ 2.0
Construction		+ 0.0	+ 1.2	- 1.5	- 0.5	+ 1.4	+ 1.7
Exports of goods ³							
Volume		+ 7.7	+13.1	+ 7.5	+ 4.3	+ 2.5	+ 3.3
Value		+ 7.0	+15.6	+ 6.5	+ 4.1	+ 2.0	+ 2.8
Imports of goods ³							
Volume		+ 6.9	+10.9	+ 5.7	- 1.6	+ 1.7	+ 3.5
Value		+ 6.7	+14.7	+ 5.0	- 2.2	+ 0.9	+ 2.7
Current balance	billion €	- 6.33	- 5.36	- 3.94	+ 1.57	+ 0.80	+ 0.45
As a percentage of GDP	%	- 3.2	- 2.6	- 1.9	+ 0.7	+ 0.4	+ 0.2
Long-term interest rate ⁴	%	4.7	5.6	5.1	5.0	3.9	4.0
Consumer prices		+ 0.6	+ 2.3	+ 2.7	+ 1.8	+ 1.3	+ 1.3
Unemployment rate							
Percent of total labour force ⁵	%	4.0	3.7	3.6	4.3	4.3	4.4
Percent of dependent labour force ⁶	%	6.7	5.8	6.1	6.9	7.0	7.1
Dependent employment ⁷		+ 1.2	+ 1.0	+ 0.4	- 0.5	+ 0.1	+ 0.3
General government financial balance according to Maastricht definition							
As a percentage of GDP	%	- 2.3	- 1.5	+ 0.3	- 0.6	- 1.1	- 1.2

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.

The high euro exchange rate is dampening price increases. Headline inflation is expected at only 1.3 percent, both this year and next. Prices of energy, industrial goods and food will be of stabilising influence, while rents will exert upward pressure (+5 percent).

Sluggish activity and the sustained strong increase in labour supply will drive unemployment further up, to a projected total of 239,000 this year and 244,000 in 2004. This corresponds to an unemployment rate of 7.1 percent of the dependent labour force according to the conventional national definition, or 4.4 percent of the total labour force (Eurostat definition). It is only the rising number of participants in labour market training and the "part-time retirement" programme that will cause the number of actively employed to edge up by 2,000 this year. A further gain of 10,000 projected for next year will again not be generated by a cyclical recovery, but by institutional changes in employment registration. The employment ratio in Austria, according to the labour force concept of Eurostat, is close to 68 percent of the working-age population and thus not much below the EU target for 2010. However, according to the traditional Austrian calculation following the means-of-living concept, it is only 62 percent, as only those people are counted as employed whose income exceeds a minimum threshold.

Government tax revenues have developed favourably in the first semester 2003. On the expenditure side, however, the strong rise in family benefit payments is weighing on the budgetary balance. The general government deficit in the Maastricht definition is projected at 1.1 percent of GDP for the current year. The downward revision of the growth forecast is of little influence in this regard, as it is mainly due to weaker export growth. Next year, however, the cyclical impact should be felt more strongly, leading to an expected deficit of 1.2 percent of GDP.