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 **ÖSTERREICHISCHES INSTITUT FÜR  
WIRTSCHAFTSFORSCHUNG**

**International Downturn Weighing  
On Domestic Activity**

**Economic Outlook for 2008 and 2009**

Marcus Scheiblecker

October 2008

# International Downturn Weighing On Domestic Activity

## Economic Outlook for 2008 and 2009

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Oktober 2008

Austrian Institute of Economic Research

### Abstract

Following an increase by 3.1 percent in 2007, economic growth in Austria will moderate to 2 percent this year. While demand and output in the first half of 2008 were clearly more dynamic than in the euro area as a whole, the momentum has slowed steadily since the beginning of the year. Confidence among domestic companies is receding. The cyclical downturn in the USA, high oil prices and exchange rate moves holding back export growth will continue to burden the economy in 2009. Real GDP is expected to advance by a modest 0.9 percent, overshadowing developments also on the labour market where employment growth will level off and the fall in unemployment turn around. The projections rest on the assumption that the adverse effects of the financial market crisis on the real economy will be contained.

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## Economic Outlook for 2008 and 2009: International Downturn Weighing On Domestic Activity

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*Following an increase by 3.1 percent in 2007, economic growth in Austria will moderate to 2 percent this year. While demand and output in the first half of 2008 were clearly more dynamic than in the euro area as a whole, the momentum has slowed steadily since the beginning of the year. Confidence among domestic companies is receding. The cyclical downturn in the USA, high oil prices and exchange rate moves holding back export growth will continue to burden the economy in 2009. Real GDP is expected to advance by a modest 0.9 percent, overshadowing developments also on the labour market where employment growth will level off and the fall in unemployment turn around. The projections rest on the assumption that the adverse effects of the financial market crisis on the real economy will be contained.*

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Global economic activity is losing steam this year and next, with the downturn covering the USA, Japan and Europe. In the USA, expansionary policy measures will support economic growth in 2008 and 2009, by which time business activity should gradually recover. The crisis on real estate and financial markets will nevertheless continue to weigh on US growth for the next years.

Following the lively momentum at the beginning of the year, demand and output in the euro area have slackened considerably. This is a consequence not so much of the financial crisis in the USA but rather of the cyclical downturn in the world's leading economy, the high dollar-euro exchange rate and the drain in purchasing power caused by the jump in commodity prices. Unlike in the USA, policy in the euro area is largely refraining from taking counter-cyclical action. GDP growth is expected to trail that in the USA in both years. Also in the euro area, a cyclical turnaround is unlikely to set in before mid-2009.

The international economic downturn is taking its toll also on activity in Austria. While, unlike in the euro area as a whole, GDP increased further in the second quarter 2008,

the regular business survey points to an imminent loss of momentum. Notably exports should suffer further from the slackening demand abroad as well as from the adverse exchange rate to the dollar. Volume exports in 2008 will rise by only half the rate recorded last year and diminish further in 2009.

With the slower pace of activity, investment is likely to level off. After an increase by 4.7 percent in 2007, gross fixed capital formation is projected to advance by only 2.2 percent this year and to remain flat in 2009. Whereas construction investment is keeping up the lively pace of last year, spending on machinery and business equipment is edging up by less than half the rate of 2007. In 2009, the slowdown will extend to both components of corporate spending, with equipment investment even shrinking in real terms.

Private consumption is set to remain subdued over the years to come. While the deceleration of inflation and the expansionary stance of fiscal policy will boost household disposable income, developments on the labour market will have a dampening influence. Private household consumption is projected to expand by just above 1 percent in volume each in 2008 and 2009.

Domestic headline inflation peaked in June 2008 and has since moved to a gradual downward trend. The easing of commodity and agricultural product prices should allow the decline to continue. The annual rate for 2008 will nevertheless be close to 3.4 percent. In 2009, price pressures should further abate; in addition, the cut in VAT for medicines and the abolition of student fees will have a dampening impact. The rate of inflation is set to moderate to 2.2 percent.

Although economic growth in Austria is gradually losing steam, the labour market has been remarkably resilient so far. In August, employment still went up by 80,000 or 2.4 percent year-on-year and unemployment diminished by 3.8 percent or 7,000 persons. However, compared with the previous month, a turnaround is already visible. In 2009, employment will only increase by 0.5 percent on account of the subdued cyclical conditions, and the rate of unemployment as measured by conventional national definitions will edge up from 5.8 percent to 6.3 percent.

Government tax revenues continued to grow strongly in 2008. Despite the increase in public expenditure, the general government balance shows a ratio of -0.6 percent of GDP. In 2009, the business cycle slowdown will be reflected in the government accounts: including the discretionary increase in expenditure decided so far, the deficit will widen to 1 percent of GDP in 2009. Although fiscal policy moves thereby to an expansionary stance that is warranted by cyclical conditions, it does not honour its commitments to budgetary savings as laid down in the latest update of the Stability Programme.

Vienna, 2 October 2008

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Projections - September 2008

## Main results

Percentage changes from previous year

		2004	2005	2006	2007	2008	2009
<b>GDP</b>							
Volume		+ 2.5	+ 2.9	+ 3.4	+ 3.1	+ 2.0	+ 0.9
Value		+ 4.2	+ 5.0	+ 5.3	+ 5.3	+ 4.9	+ 3.2
<b>Manufacturing<sup>1</sup>, volume</b>		+ 3.0	+ 4.8	+ 9.6	+ 5.5	+ 3.2	+ 0.5
<b>Wholesale and retail trade, volume</b>		- 0.0	+ 2.2	- 1.0	+ 1.5	+ 1.2	+ 1.1
<b>Private consumption expenditure, volume</b>		+ 2.2	+ 2.6	+ 2.4	+ 1.0	+ 1.0	+ 1.2
<b>Gross fixed investment, volume</b>		+ 0.7	+ 2.4	+ 2.6	+ 4.7	+ 2.2	+ 0.0
Machinery and equipment <sup>2</sup>		- 0.4	+ 5.5	+ 0.9	+ 6.8	+ 2.5	- 0.5
Construction		+ 1.6	- 0.4	+ 4.2	+ 2.8	+ 2.0	+ 0.5
<b>Exports of goods<sup>3</sup></b>							
Volume		+ 12.7	+ 3.2	+ 6.8	+ 8.7	+ 4.1	+ 3.1
Value		+ 13.9	+ 5.4	+ 9.5	+ 10.5	+ 5.5	+ 3.3
<b>Imports of goods<sup>3</sup></b>							
Volume		+ 11.2	+ 2.9	+ 4.1	+ 8.0	+ 3.8	+ 2.7
Value		+ 12.5	+ 5.9	+ 8.0	+ 9.6	+ 6.2	+ 2.9
<b>Current balance</b>	€ bn	+ 4.84	+ 4.92	+ 6.29	+ 8.76	+ 8.06	+ 7.66
	as a percentage of GDP	+ 2.1	+ 2.0	+ 2.4	+ 3.2	+ 2.8	+ 2.6
<b>Long-term interest rate<sup>4</sup></b>	percent	4.2	3.4	3.8	4.3	4.3	4.1
<b>Consumer prices</b>		+ 2.1	+ 2.3	+ 1.5	+ 2.2	+ 3.4	+ 2.2
<b>Unemployment rate</b>							
Eurostat definition <sup>5</sup>	percent	4.8	5.2	4.8	4.4	3.9	4.2
National definition <sup>6</sup>	percent	7.1	7.3	6.8	6.2	5.8	6.3
<b>Persons in active dependent employment<sup>7</sup></b>		+ 0.7	+ 1.0	+ 1.7	+ 2.1	+ 2.4	+ 0.5
<b>General government financial balance</b>							
	according to Maastricht definition						
	as a percentage of GDP	- 4.4	- 1.5	- 1.5	- 0.4	- 0.6	- 1.0

<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> Public Employment Service Austria, percent of total labour force excluding self employed. <sup>7</sup> Excluding parental leave, military service, and unemployed persons in training.

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Projections - September 2008

**Key policy indicators**

	2004	2005	2006	2007	2008	2009
<b><i>Fiscal policy</i></b>						
	As a percentage of GDP					
<b>General government financial balance</b>						
according to Maastricht definition	- 4.4	- 1.5	- 1.5	- 0.4	- 0.6	- 1.0
according to National accounts	- 4.5	- 1.6	- 1.7	- 0.5	- 0.7	- 1.2
<b>General government primary balance</b>	- 1.5	+ 1.4	+ 1.2	+ 2.3	+ 2.1	+ 1.7
<b><i>Monetary policy</i></b>						
	Percent					
3-month interest rate	2.1	2.2	3.1	4.3	4.8	4.7
Long-term interest rate <sup>1</sup>	4.2	3.4	3.8	4.3	4.3	4.1
	Percentage changes from previous year					
<b>Effective exchange rate</b>						
Nominal	+ 1.5	- 0.7	+ 0.2	+ 1.1	+ 1.7	± 0.0
Real	+ 1.0	- 1.0	- 0.5	+ 0.7	+ 0.9	- 1.0

<sup>1</sup> 10-year central government bonds (benchmark).

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*Projections - September 2008*

## World economy

Percentage changes from previous year

	2004	2005	2006	2007	2008	2009
<b>Real GDP</b>						
World	+ 4.9	+ 4.4	+ 5.0	+ 4.9	+ 4.0	+ 3.2
Total OECD	+ 3.1	+ 2.4	+ 3.0	+ 2.5	+ 1.5	+ 1.0
USA	+ 3.6	+ 2.9	+ 2.8	+ 2.0	+ 1.7	+ 0.9
Japan	+ 2.7	+ 1.9	+ 2.4	+ 2.1	+ 1.1	+ 0.7
EU 27	+ 2.5	+ 1.9	+ 3.1	+ 2.9	+ 1.6	+ 1.0
Euro area 16	+ 2.1	+ 1.7	+ 2.8	+ 2.6	+ 1.2	+ 0.7
New member states <sup>1</sup>	+ 5.7	+ 4.8	+ 6.6	+ 6.0	+ 4.4	+ 3.5
China	+ 10.1	+ 10.4	+ 11.1	+ 11.4	+ 9.5	+ 8.2
<b>World trade, volume</b>	+ 11.1	+ 8.2	+ 9.5	+ 7.1	+ 4.8	+ 4.0
<b>Market growth<sup>2</sup></b>	+ 9.4	+ 7.5	+ 11.0	+ 7.6	+ 4.8	+ 2.8
<b>Primary commodity prices</b>						
HWWI Index, total	+ 18.5	+ 28.5	+ 19.7	+ 3.7	+ 28	- 3
Excluding energy	+ 18.1	+ 5.6	+ 22.0	+ 9.5	+ 14	- 9
<b>Crude oil prices</b>						
Brent, USD per barrel	38.2	54.4	65.1	72.5	105.0	90.0
<b>Exchange rate</b>						
USD per euro	1.243	1.245	1.256	1.371	1.50	1.40

<sup>1</sup> Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania.

<sup>2</sup> Real import growth of trading partners weighted by Austrian export shares.



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*Projections - September 2008*

**Private consumption, income and prices**

	2004	2005	2006	2007	2008	2009
	Percentage changes from previous year, volume					
<b>Private consumption expenditure</b>	+ 2.2	+ 2.6	+ 2.4	+ 1.0	+ 1.0	+ 1.2
Durables	+ 3.7	+ 5.9	+ 7.0	+ 6.2	+ 0.8	+ 1.7
Non-durables and services	+ 2.1	+ 2.2	+ 1.9	+ 0.4	+ 1.0	+ 1.1
<b>Household disposable income</b>	+ 2.4	+ 3.1	+ 3.5	+ 2.2	+ 1.0	+ 1.1
<b>Household saving ratio</b>						
As a percentage of disposable income	9.4	9.8	10.8	11.7	11.5	11.4
	Percentage changes from previous year					
<b>Direct lending to domestic non-banks<sup>1</sup></b>	+ 5.0	+ 4.7	+ 4.5	+ 3.6	+ 4.3	+ 4.2
<b>Inflation rate</b>						
National	2.1	2.3	1.5	2.2	3.4	2.2
Harmonised	2.0	2.1	1.7	2.2	3.4	2.2
Core inflation <sup>2</sup>	1.6	1.5	1.3	1.9	2.5	2.1

<sup>1</sup> End of period.

<sup>2</sup> Excluding unprocessed food (meat, fish, fruits, vegetables) and energy items.

## Productivity

Percentage changes from previous year

	2004	2005	2006	2007	2008	2009
<b>Total economy</b>						
Real GDP	+ 2.5	+ 2.9	+ 3.4	+ 3.1	+ 2.0	+ 0.9
Employment <sup>1</sup>	+ 0.4	+ 1.1	+ 1.5	+ 1.7	+ 1.7	+ 0.4
<b>Productivity</b> (GDP per employment)	+ 2.2	+ 1.7	+ 1.9	+ 1.3	+ 0.3	+ 0.6
<b>Manufacturing</b>						
Production <sup>2</sup>	+ 2.9	+ 4.8	+ 9.9	+ 5.5	+ 3.2	+ 0.5
Employees <sup>3</sup>	- 0.6	- 0.8	+ 0.2	+ 2.6	+ 0.9	- 1.7
<b>Productivity per hour</b>	+ 2.7	+ 6.2	+ 9.5	+ 3.2	+ 2.1	+ 2.6
Working hours per day per employee <sup>4</sup>	+ 0.8	- 0.6	+ 0.2	- 0.3	+ 0.2	- 0.4

<sup>1</sup> Dependent and self-employed according to National Accounts definition.

<sup>2</sup> Value added, volume.

<sup>3</sup> According to Federation of Austrian Social Security Institutions.

<sup>4</sup> According to 'Konjunkturerhebung' of Statistics Austria.

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Projections - September 2008

## Earnings and international competitiveness

Percentage changes from previous year

	2004	2005	2006	2007	2008	2009
<b>Gross earnings</b> per employee <sup>1</sup>	+ 1.8	+ 2.4	+ 3.2	+ 2.3	+ 3.0	+ 3.3
<b>Gross real earnings</b> per employee <sup>1</sup>	- 0.2	+ 0.1	+ 1.4	+ 0.1	- 0.4	+ 1.1
<b>Net real earnings</b> per employee <sup>1</sup>	- 0.1	+ 0.7	+ 1.3	- 0.0	- 0.8	+ 0.7
<i>Total economy</i>						
<b>Unit labour costs</b>	- 0.6	+ 0.7	+ 1.1	+ 0.8	+ 3.0	+ 2.7
<i>Manufacturing</i>						
<b>Unit labour costs</b>	- 1.7	- 0.9	- 4.4	- 0.6	+ 1.0	+ 1.3
<b>Relative unit labour costs</b> <sup>2</sup>						
Vis-à-vis trading partners	+ 1.0	- 0.1	- 2.9	+ 1.0	+ 1.3	± 0.0
Vis-à-vis Germany	+ 1.3	+ 1.7	- 1.6	+ 2.5	± 0.0	- 1.2
<b>Effective exchange rate - manufactures</b>						
Nominal	+ 1.5	- 0.6	+ 0.2	+ 1.2	+ 1.7	- 0.1
Real	+ 1.1	- 0.9	- 0.4	+ 0.8	+ 1.0	- 1.0

<sup>1</sup> Employees according to National Accounts definition.

<sup>2</sup> In a common currency; minus sign indicates improvement of competitiveness.

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Projections - September 2008

## Labour market

Changes from previous year (1,000<sup>s</sup>)

	2004	2005	2006	2007	2008	2009	
<b>Demand for labour</b>							
Persons in active employment <sup>1</sup>	+ 25.1	+ 37.2	+ 55.9	+ 66.9	+ 86.0	+ 13.0	
Employees <sup>2</sup>	+ 21.1	+ 31.9	+ 51.5	+ 65.5	+ 78.0	+ 15.0	
<i>Percentage changes from previous year</i>	+ 0.7	+ 1.0	+ 1.7	+ 2.1	+ 2.4	+ 0.5	
Nationals	+ 9.2	+ 20.0	+ 35.0	+ 43.6	+ 54.0	+ 5.5	
Foreign workers	+ 11.9	+ 11.9	+ 16.5	+ 21.9	+ 24.0	+ 9.5	
Self-employed <sup>3</sup>	+ 4.0	+ 5.3	+ 4.4	+ 1.4	+ 8.0	- 2.0	
<b>Labour supply</b>							
Population of working age (15 to 64 years)	+ 34.4	+ 15.6	+ 18.5	+ 17.4	+ 18.0	+ 20.2	
(15 to 59 years)	+ 35.6	+ 48.5	+ 52.8	+ 18.8	+ 8.5	+ 13.7	
Labour force <sup>4</sup>	+ 28.9	+ 45.9	+ 42.4	+ 50.0	+ 72.5	+ 37.0	
<b>Surplus of labour</b>							
Registered unemployed <sup>5</sup>	+ 3.8	+ 8.8	- 13.5	- 16.9	- 13.5	+ 24.0	
1,000 <sup>s</sup>	243.9	252.7	239.2	222.2	208.7	232.7	
<b>Unemployment rate</b>							
Eurostat definition <sup>6</sup>	percent	4.8	5.2	4.8	4.4	3.9	4.2
Percent of total labour force <sup>5</sup>	percent	6.4	6.5	6.1	5.6	5.2	5.7
National definition <sup>5,7</sup>	percent	7.1	7.3	6.8	6.2	5.8	6.3
<b>Employment rate</b>							
Persons in active employment <sup>1,8</sup>	percent	62.3	62.8	63.6	64.5	65.9	65.9
Total employment (Eurostat) <sup>6,8,9</sup>	percent	67.8	68.6	70.2	71.4	72.8	72.8

<sup>1</sup> Excluding parental leave, military service, and unemployed persons in training. <sup>2</sup> According to Federation of Austrian Social Security Institutions. <sup>3</sup> According to WIFO. <sup>4</sup> Economically active employment plus unemployment.

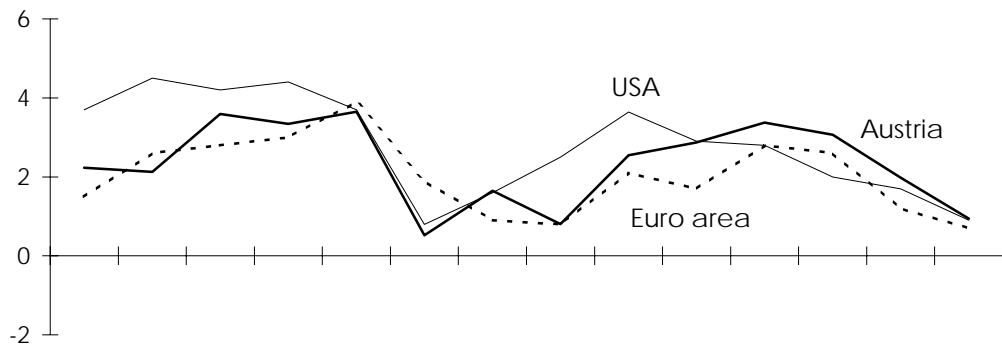
<sup>5</sup> According to Public Employment Service Austria. <sup>6</sup> According to Eurostat Labour Force Survey.

<sup>7</sup> Percent of total labour force excl. self-employed. <sup>8</sup> Percent of population of working age (15 to 64 years).

<sup>9</sup> Changed survey method.

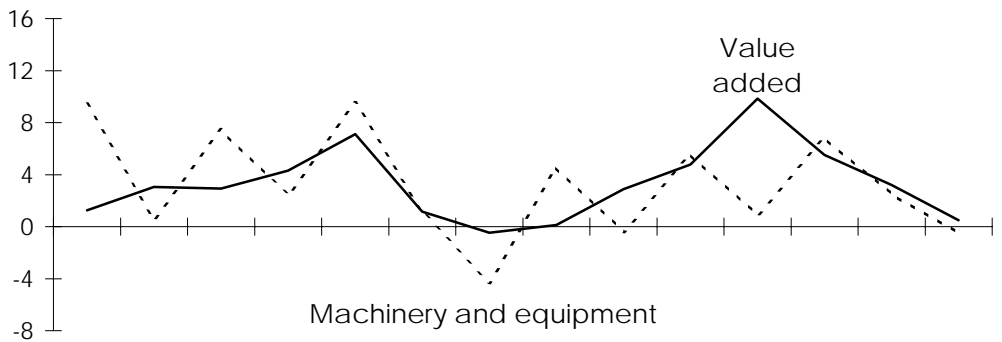
### Growth of real GDP

Percent



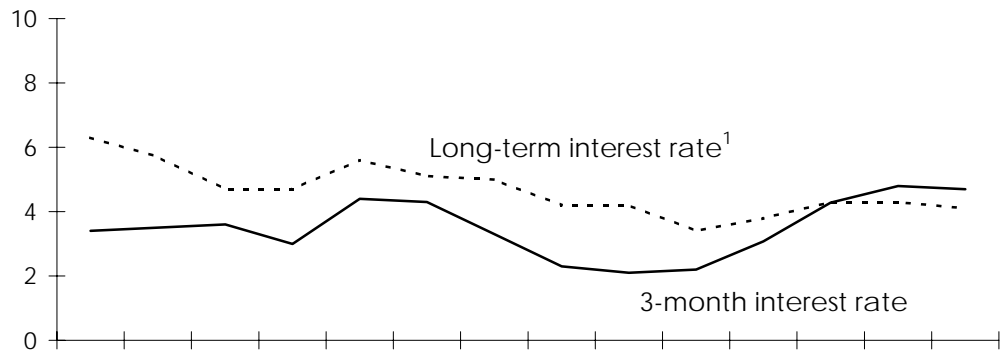
### Manufacturing and investment

Percentage changes from previous year, volume



### Short-term and long-term interest rates

Percent



### Trade

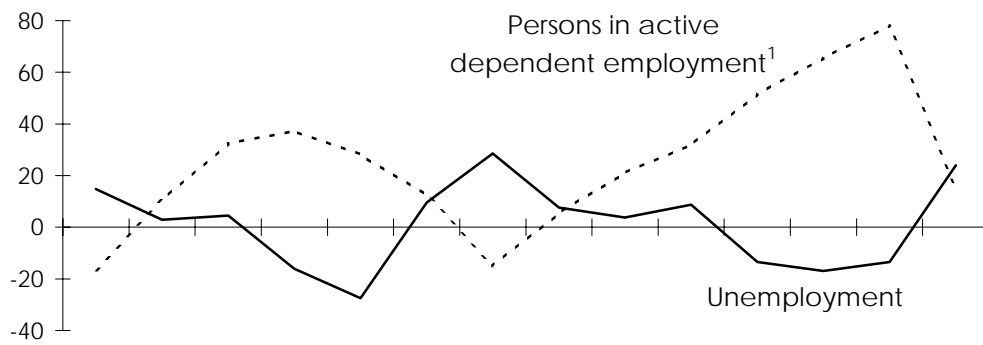
Percentage changes from previous year, volume



<sup>1</sup> 10-year central government bonds (benchmark).

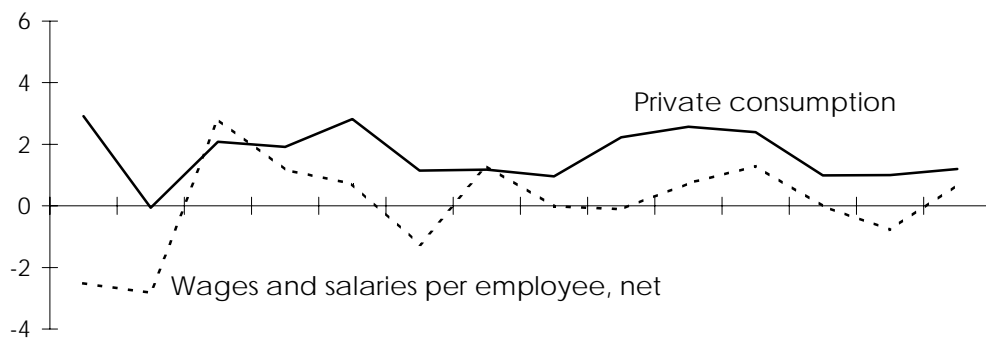
## Employment and unemployment

1,000<sup>s</sup> from previous year



## Consumption and income

Percentage changes from previous year, volume



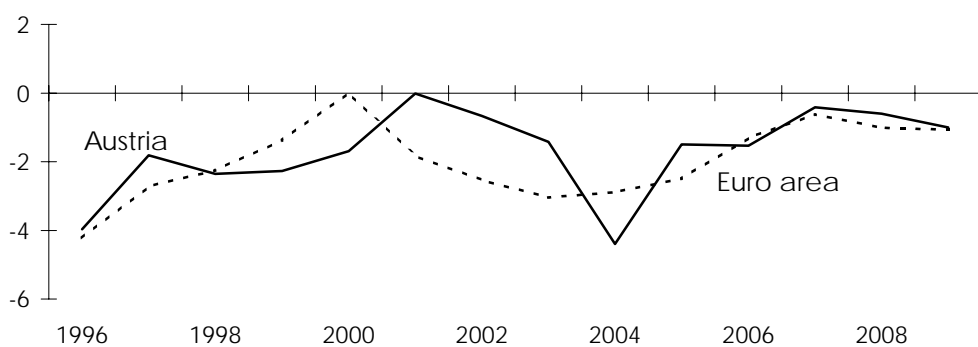
## Inflation and unit labour costs

Percentage changes from previous year



## General government financial balance

As a percentage of GDP



<sup>1</sup> Excluding parental leave, military service, and unemployed persons in training.