

MARKUS MARTERBAUER

MAJOR RISKS FOR THE WORLD ECONOMY, SLUMP IN DOMESTIC CONSTRUCTION DEMAND

ECONOMIC OUTLOOK FOR 2001 AND 2002

Under benign assumptions concerning the international business cycle, the Austrian economy should grow by 1.3 percent in volume this year, and by 1.9 percent in 2002, provided that the U.S. economy recovers and policy in the EU takes action to stem the forces of recession. Along with weaker foreign demand, domestic factors are also dampening growth. In particular the construction sector is in a crisis, affecting building of new structures and civil engineering alike. Unemployment is set to rise significantly, exceeding 6 percent of the dependent labour force, while inflation should decelerate. Due to the effect of automatic budgetary stabilisers, the general government balance in 2002 may be in deficit of around ATS 10 billion (EUR 0.74 billion), equivalent to 0.3 percent of GDP. The public sector should thereby contribute towards sustaining economic activity.

All staff members of the Austrian Institute of Economic Research contribute to the Economic Outlook. E-mail address: Markus.Marterbauer@wifo.ac.at • Cut-off date: 26 September, 2001

The terrorist attacks of 11 September have hit the economy in the USA and the world at large at a moment when the cyclical situation was already extremely fragile. Even before these events, the U.S. economy was on the verge of recession. Japan and some areas in Latin America and South East Asia were already in deep crisis, and in Europe economic growth almost came to a halt in the second quarter. At present, it is still too early to assess even the direct economic consequences of the tragic events to a reasonable degree of certainty. They depend on further international developments, the economic policy response in the industrialised countries, and the impact on business and consumer expectations.

For the purpose of the present short-term projections, WIFO has chosen cautiously optimistic assumptions. Thus, from a short recession, the U.S. economy should quickly recover as from next spring, driven mainly by monetary and fiscal expansion. GDP may increase by 1 percent in volume for the whole year 2001, and by 2 percent in 2002. In the EU, interest rate and budgetary policies should help sustain business activity. While due to the operation of automatic fiscal stabilisers several EU countries may miss their budgetary targets, a slump in investment and consumer demand should thereby be avoided. Under these assumptions, the European economy is expected to expand by 1½ percent in real terms in 2001 and, benefiting rather quickly from a rebound in the USA, by 2 percent in 2002.

Under the impact of the international slowdown, economic activity in Austria has lost momentum since the middle of 2000. Sectors highly depending on developments abroad, i.e., goods exports, manufacturing, investment in machinery and equipment, wholesale trade, have fared hardly worse than projected by WIFO three months ago. Tourism earnings and the output of corresponding services (hotels, restaurants, etc.) are growing even more than expected, although foreign and domestic spending on travel will likely be weak in 2002, given the fragile international situation.

Domestic demand is proving significantly weaker than assumed before mid-year. To a large part this is accounted for by construction activity which fell by 5½ percent in volume in the second quarter. Residential building is receding due to lack of demand. The boom in the creation of new office space over the past years has led to excess capacity, suggesting a decline in output in the near future also in this sector. Road construction is suffering from investment spending restraint of the Federal states and municipalities. The decline is extending also to railroad construction, although a number of projects should

be ready for implementation and the need for such infrastructure is uncontested. For the construction sector as a whole, output is set to fall by an inflation-adjusted 3 percent in 2001, and probably by a further 2 percent in 2002.

Table 1: Main results

		1997	1998	1999	2000	2001	2002
		Percentage changes from previous year					
GDP							
Volume		+ 1.3	+ 3.3	+ 2.8	+ 3.3	+ 1.3	+ 1.9
Value		+ 2.6	+ 4.0	+ 3.7	+ 4.5	+ 2.7	+ 3.5
Manufacturing ¹ , volume		+ 4.2	+ 4.4	+ 2.4	+ 8.3	+ 2.3	+ 3.0
Private consumption expenditure, volume		+ 1.4	+ 2.9	+ 2.3	+ 2.7	+ 1.5	+ 1.9
Gross fixed investment, volume		+ 1.0	+ 2.7	+ 3.2	+ 3.4	+ 0.9	+ 0.5
Machinery and equipment ²		+ 5.4	+ 5.2	+ 4.6	+ 6.0	+ 1.8	+ 3.5
Construction		- 2.0	+ 0.9	+ 2.2	+ 1.3	- 3.0	- 2.0
Exports of goods ³							
Volume		+ 16.5	+ 8.1	+ 7.7	+ 13.0	+ 4.5	+ 5.2
Value		+ 16.8	+ 8.4	+ 7.0	+ 15.6	+ 7.3	+ 7.8
Imports of goods ³							
Volume		+ 9.4	+ 7.1	+ 6.9	+ 8.7	+ 4.5	+ 4.5
Value		+ 10.9	+ 6.6	+ 6.7	+ 14.7	+ 7.8	+ 7.6
Current balance	billion ATS	- 79.2	- 64.5	- 87.1	- 78.6	- 76.0	- 74.1
	billion EUR			- 6.33	- 5.71	- 5.53	- 5.38
As a percentage of GDP	in percent	- 3.2	- 2.5	- 3.2	- 2.8	- 2.6	- 2.5
Long-term interest rate ⁴	in percent	5.7	4.7	4.7	5.6	5.0	4.7
Consumer prices		+ 1.3	+ 0.9	+ 0.6	+ 2.3	+ 2.6	+ 1.9
Unemployment rate							
Percent of total labour force ⁵	in percent	4.4	4.5	4.0	3.7	3.8	3.8
Percent of dependent labour force ⁶	in percent	7.1	7.2	6.7	5.8	6.0	6.1
Dependent employment ⁷		+ 0.4	+ 1.0	+ 1.2	+ 1.0	+ 0.4	+ 0.4
General government financial balance							
As a percentage of GDP	in percent	- 1.9	- 2.4	- 2.2	- 1.1	- 0.7	- 0.3

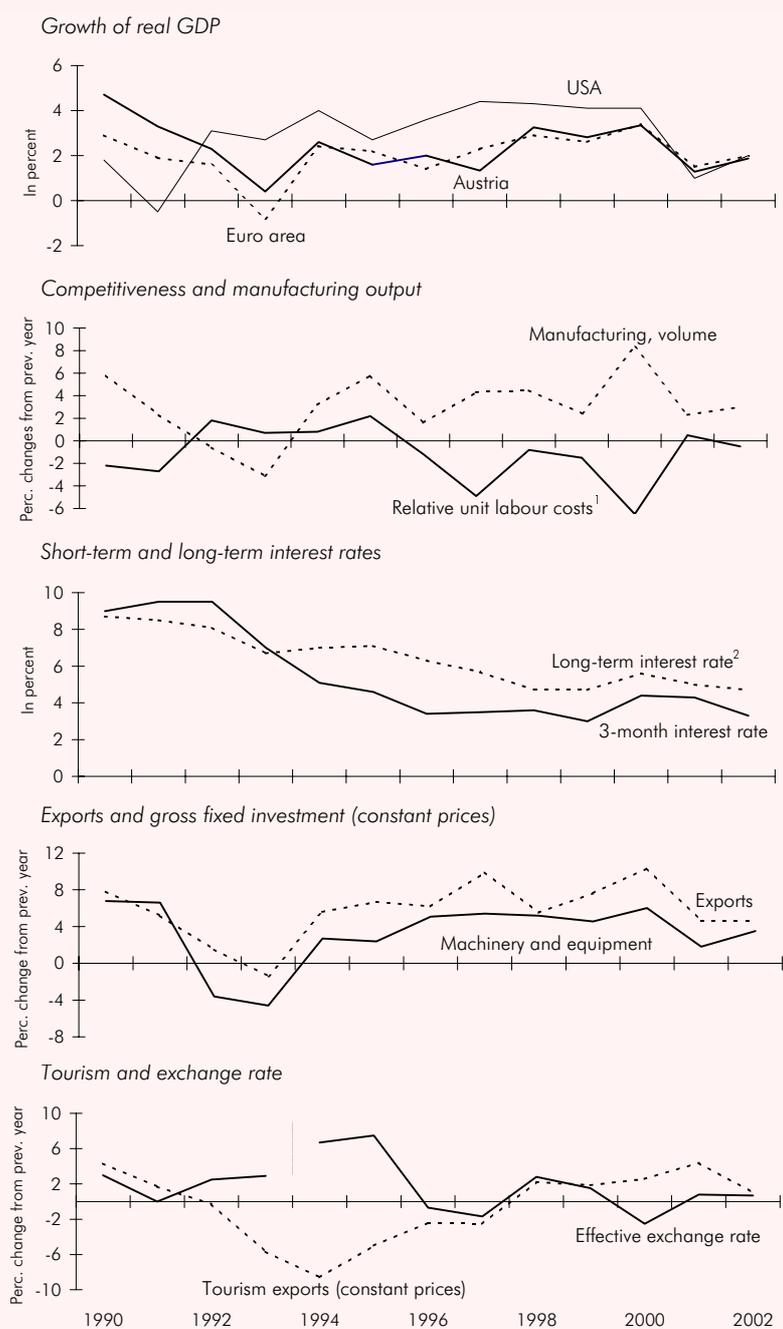
¹ Value added, including mining and quarrying. – ² Including other products. – ³ According to Statistics Austria. – ⁴ 10-year central government bonds (benchmark). – ⁵ According to Eurostat. – ⁶ According to Labour Market Service. – ⁷ Excluding parental leave and military service.

While real disposable income of households is being eroded by inflation and sizeable tax increases, private consumption may still advance by around 1½ percent this year. This projection hinges on the (optimistic) assumption of a marked decline in household saving as a ratio of disposable income, from 8 percent in 2000 to 6.6 percent in 2001. With income growth picking up slightly, consumption may rise by 1.9 percent in volume in 2002. Inflation should further decelerate, provided energy prices remain stable. Headline inflation could then moderate from 2.6 percent in 2001 to 1.9 percent.

The marked business cycle downturn is weakening labour market conditions. While the overall number of employees may rise by a steady 12,000 or 0.4 percent p.a., the gains are almost entirely going to part-time jobs. Cuts in the workforce will mainly affect construction, public administration as well as transport and telecommunication services. Unemployment is rising to a total close to 200,000 on annual average 2001, corresponding to a jobless rate of 3.8 percent of the labour force (Eurostat definition) or 6.0 percent of the dependent labour force. In view of GDP growth remaining below trend in 2002, a further increase in unemployment should be expected.

Government budgets are also adversely affected by the cyclical slackening. Revenues from wage and sales taxes are rising more slowly, while claims for unemployment benefits go up. The general government balance will therefore be somewhat weaker than expected by WIFO three months ago (-0.7 percent of GDP). In 2002, the cyclical component may keep the balance in small deficit of 0.3 percent of GDP.

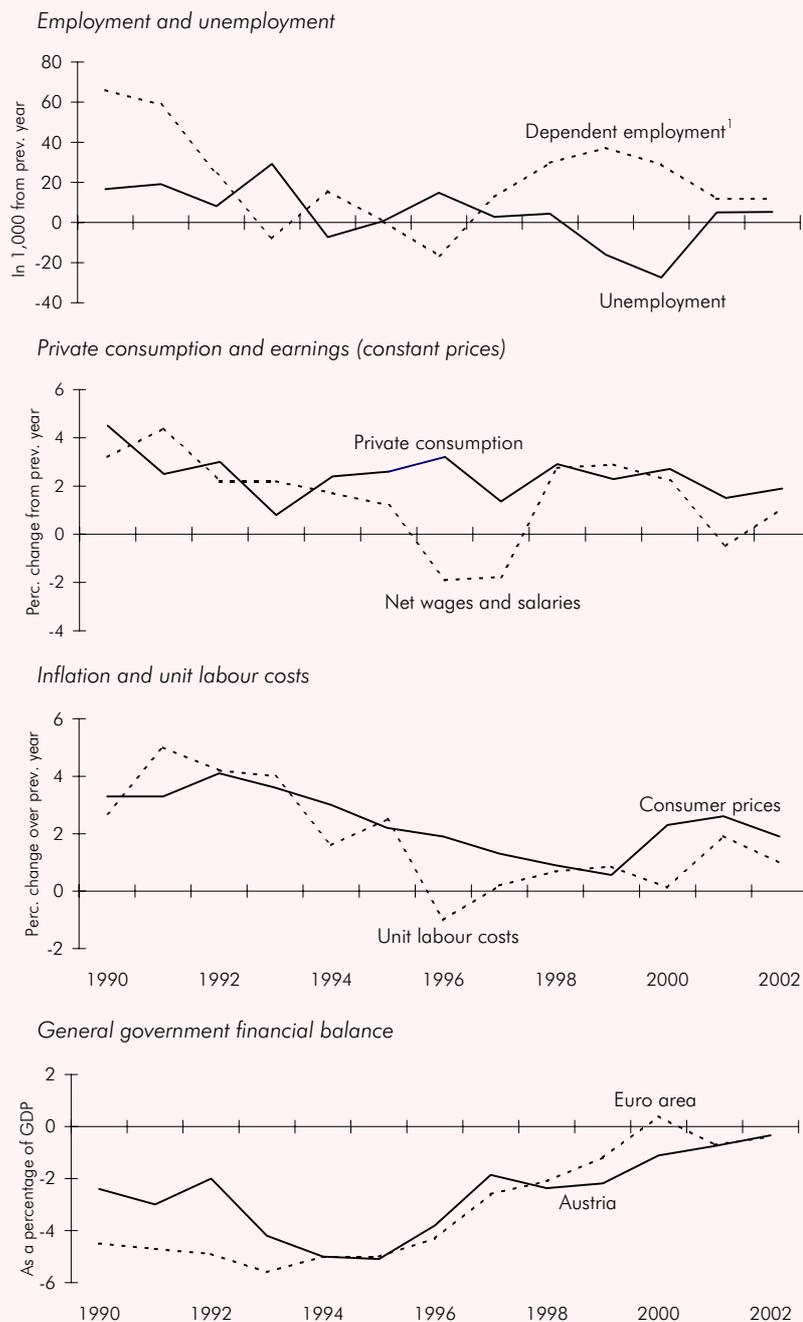
Figure 1: International context



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

The present projections have been elaborated under an unusually large degree of uncertainty, with risks being clearly biased to the downside. If the recession in the USA were to be deepened by a sharper-than-anticipated fall in business and consumer sentiment, and if fiscal policy in the EU should not play its stabilising role to full extent, GDP growth in Austria may fall substantially below the path outlined in this scenario. A further somewhat optimistic element is implied by the assumed marked fall in the saving ratio, giving private consumption a key role in sustaining overall demand and output.

Figure 2: Economic performance



¹ Excluding parental leave and military service.

Since the middle of last year, business activity in the USA has been on a clear downward trend. By the second quarter 2001, economic growth almost ground to a halt. The labour market has weakened markedly, with the rate of unemployment rising to 4.9 percent of late. Manufacturing output has dropped by around 5 percent since September 2000, and capacity utilisation is at its lowest level since 1983. Investment in machinery and equipment also fell sharply over the last few quarters, notably capital spending on information and communication technology. Nevertheless, since spring some leading indicators, such as the index of purchasing managers, have signalled a timid recovery, and also the run-down of inventories in the second quarter raised hopes for an early pick-up of production. Private household demand and construction, both spurred by the massive cuts in interest rates, have so far provided major support to over-

**Terrorist attacks hitting
U.S. economy in a
critical phase**

all activity, although consumer confidence and retail sales have slackened noticeably in recent months.

The terrorist assault of 11 September has thus hit the U.S. economy in a fragile situation. Its economic repercussions are not sufficiently clear at this early moment. They will depend on the political and military response, on the impact of the events on business and consumer confidence, and on the way economic policy reacts.

For the purpose of the present projections, WIFO has retained a benign scenario, which it gives some chance of materialising. The attacks are believed to have major effects in three areas: first, the reversal on stock markets will further undermine consumer confidence, albeit for a short time; second, oil prices may react to a situation of heightened international conflict; and third, parts of the service sector (e.g., insurance, air traffic), that have so far been a mainstay of business activity, are taking direct damage. It is thus likely, that some spending on durable consumer goods and investment capital will be deferred. Growth of U.S. real GDP may therefore be zero or negative in the second semester 2001 and probably also in the first quarter of 2002, which would amount to a recession.

These negative influences are being countered by economic policy, which has opted for comprehensive cyclical stimulation. Short-term interest rates, which had been cut to less than half from the beginning of the year to early September, are being lowered even further in a distinctly pro-active stance of Federal Reserve policy after the attacks. Budgetary policy is also acting strongly expansionary, with tax cuts benefiting primarily the lower income brackets (tax rebate checks) taking effect since mid-year, and with large-scale expenditure programmes being launched after the attacks. In a first step, Congress has approved additional outlays up to \$ 40 billion, roughly ½ percent of GDP. While the central government budget will thereby soon slip into deficit, the measures, on the other hand, provide the much-needed impulse for cyclical stabilisation.

By summer, the U.S. economy was close to a recession, with only few indicators pointing to a tentative recovery. Since the events of 11 September, uncertainties have increased drastically, and it is difficult to predict, where the economy is heading in the short term. Economic policy does what it can do to prevent a deep recession.

Table 2: World economy

	1997	1998	1999	2000	2001	2002	
	Percentage changes from previous year						
<i>Real GDP</i>							
Total OECD	+ 3.2	+ 2.3	+ 2.9	+ 3.4	+ 0.7	+ 1.8	
USA	+ 4.4	+ 4.3	+ 4.1	+ 4.1	+ 1.0	+ 2.0	
Japan	+ 1.8	- 1.1	+ 0.8	+ 1.5	- 1.0	+ 1.0	
EU	+ 2.5	+ 2.9	+ 2.6	+ 3.4	+ 1.5	+ 2.0	
Euro area	+ 2.3	+ 2.9	+ 2.6	+ 3.4	+ 1.5	+ 2.0	
Germany	+ 1.4	+ 2.0	+ 1.8	+ 3.0	+ 1.0	+ 1.5	
Central Eastern Europe ¹	+ 4.7	+ 3.6	+ 3.2	+ 3.9	+ 2.8	+ 4.0	
<i>World trade, volume</i>	+ 10.0	+ 5.6	+ 6.2	+ 12.9	+ 5.0	+ 6.0	
OECD exports	+ 11.0	+ 5.5	+ 5.4	+ 12.0	+ 6.5	+ 7.9	
Intra-OECD trade	+ 11.3	+ 8.3	+ 7.8	+ 11.6	+ 4.5	+ 6.5	
<i>Market growth²</i>	+ 9.7	+ 11.3	+ 7.3	+ 13.3	+ 4.0	+ 5.0	
<i>Primary commodity prices, in USD</i>							
HWWA index, total, 1990 = 100	- 2.0	- 22.0	+ 12.0	+ 31.0	+ 1.0	+ 1.0	
Excluding energy	+ 0.0	- 13.0	- 8.0	+ 1.0	+ 2.0	+ 3.0	
<i>Crude oil prices</i>							
Average import price (cif) for OECD countries	USD per barrel	19.1	12.6	17.3	28.0	28.0	28.0
<i>Exchange rate</i>	USD per ECU or EUR	1.134	1.121	1.067	0.924	0.90	0.95

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

The WIFO projections assume that the expansionary policy stance will give incentives to consumption and investment, enabling the economy to overcome the forces driving it towards recession. Positive signs in this regard are expected for early 2002. Although even under such optimistic assumptions, an upturn would still set in later than expected in last June's projections, the U.S. economy could expand by 1 percent in volume in 2001, and by approximately 2 percent in 2002.

Somewhat less likely, though not to be ruled out, is deemed a scenario in which the negative forces have a much greater impact. Consumer confidence in the USA has already weakened substantially since the end of 2000, and it may be further undermined by sharp and sustained falls in stock market values affecting also retirement incomes.

This could lead to a jump in the saving ratio, which by now is close to zero, and to a marked fall in private consumption which accounts for two-thirds of total demand. Such a slump in consumer demand could hardly be countered by economic policy. Broadly the same goes for a possible shake-up in business confidence leading to further massive postponement of investment projects. In the event of such crises, the USA might also lose attractiveness for foreign financial investors, which in turn would raise problems of financing the large foreign trade deficit. Should the next few months see an escalation towards a major international conflict, repercussions could also extend to world commodity markets, and in particular the price of crude oil. The result would be sizeable losses in the terms of trade as well as in real household incomes of oil-importing countries. Under such pessimistic assumptions, the recession in the USA would turn out much deeper, lasting for most of 2002.

A particularly disquieting feature of the global outlook is the current synchronised downturn in the three major economies. In Europe and the USA, growth has ground to a halt, and Japan is in recession. Moreover, some countries in Latin America and South-east Asia are being struck by severe economic and financial crisis. This coincidence of adverse developments in major poles of the world economy marks a difference to the situation in the early 1990s and highlights the danger of a self-reinforcing downward spiral.

Further developments in Europe will crucially depend on the scenario that is going to unfold in the USA. Already over the past years, activity in Europe has been greatly supported by the direct and indirect spill-over effects from the strong U.S. expansion, while internal demand was rather subdued. Since the middle of last year, the slowdown in the USA has had a lagged dampening effect also on Europe, together with the oil-price-induced real income losses. In the second quarter 2001, EU real GDP was no higher than in the first three months, and up by only 1¾ percent from the year-earlier level. Almost all cyclical indicators have been heading downwards over the last few quarters. Whereas the Scandinavian countries are relatively more affected by the slump in investment in information and communication technology, Germany and Austria are suffering also from a crisis in the construction sector. Even before the 11 September, leading indicators did not point to a speedy recovery in Europe.

At this juncture, much will depend on the reaction of fiscal and monetary policy. The projections assume that interest rates will be cut further and automatic fiscal stabilisers be allowed to fully operate in all EU Member States. Some countries in the euro area will have difficulties in adhering to the Stability Programmes set up in a more favourable context, and in meeting the budgetary targets for 2001 and 2002 in the new circumstances. This holds particularly for Germany, Italy, France and Portugal. If, in the present situation, cyclically-induced shortfalls in tax revenues and expenditure overruns were to be compensated by new consolidation measures on either the expenditure or the revenue side, the economic downturn would only become more severe and unemployment would rise further.

A pragmatic approach adopted by the budgetary authorities could go some way towards stabilising expectations of private agents, in order to prevent a loss of confidence on the part of investors and offset cyclically-related income losses suffered by households.

Assuming an improvement in the USA in the earlier part of 2002 and the automatic fiscal stabilisers taking effect in the EU, a business cycle recovery should take hold also in Europe towards mid-year. On annual average, GDP growth may pick up from 1½ percent in 2001 to around 2 percent. Should, however, these two assumptions not materialise, Europe would probably follow the USA into a more severe downturn.

The Austrian economy is strongly determined by the ups and downs of the international business cycle. The assumptions for the global environment are therefore decisive also for the performance of key domestic sectors. In the benign basic scenario of the WIFO projections, the outward-oriented sector should develop more or less as expected three months ago. According to foreign trade data collected by Statistics Austria, goods exports rose strongly up to last April, but remained below the year-earlier level in the following months. Export revenues data from the Austrian National Bank show healthy year-on-year gains as far as July.

For the second semester, however, a marked deceleration should be expected, due to weakening demand in key trading partner countries in Western Europe. Exports to the USA jumped by 27 percent last year, benefiting mainly the suppliers of technical manufactures (machinery and vehicles account for more than half of exports to the USA). Still,

Critical state of the European economy calling for policy action

Sluggish growth of exports and manufacturing output

the direct effects of a recession in the USA should be small, as only 5 percent of all Austrian exports go to the USA. Of greater importance are indirect effects via slower growth in trading partner countries having strong links to the U.S. market. Among these are Germany and Italy, where exports to the U.S. claim around 10 percent of the total, respectively.

Overall, Austrian merchandise volume exports may advance by 4½ percent in 2001, and by just over 5 percent in 2002, provided activity in Europe recovers. An altogether favourable competitive position should allow small gains in market shares.

Manufacturing output went up by 3¾ percent in real terms in the first six months, but only 1 percent in the second quarter. Employment has been exceeding the year-earlier level until August. Nevertheless, the WIFO business survey shows a significant deterioration of the business climate, notably for the third quarter, and particularly in the cyclically sensitive parts of basic goods and technical manufactures production. Apparently, entrepreneurial confidence has not yet reached its lower turning point. Thus, for the second half, any output gains will likely be small, yielding an annual average growth rate of 2¼ percent in volume. For 2002, the underlying assumptions suggest that output growth will pick-up to a rate of 3 percent. Productivity is expected to rise below trend over the whole projection period, partly because firms will want to retain most of their qualified workforce.

The business test and the investment survey regularly conducted by WIFO pointed to weakening business expectations in manufacturing already last summer. Production in 2001 may rise by an inflation-adjusted 2¼ percent above the year-earlier level. Faster growth in 2002 would depend on an upturn in exports.

Table 3: Productivity

	1997	1998	1999	2000	2001	2002
	Percentage changes from previous year					
<i>Total economy</i>						
Real GDP	+ 1.3	+ 3.3	+ 2.8	+ 3.3	+ 1.3	+ 1.9
Employment ¹	+ 0.5	+ 0.8	+ 1.4	+ 0.9	+ 0.5	+ 0.5
Full-time equivalent	+ 0.2	+ 0.2	+ 0.6	+ 0.6	± 0.0	± 0.0
Productivity (GDP per employment)	+ 0.8	+ 2.5	+ 1.4	+ 2.5	+ 0.8	+ 1.4
Full-time equivalent	+ 1.2	+ 3.0	+ 2.2	+ 2.7	+ 1.3	+ 1.9
<i>Manufacturing</i>						
Production ²	+ 4.3	+ 4.5	+ 2.4	+ 8.3	+ 2.3	+ 3.0
Employees ³	- 1.4	+ 0.1	- 0.7	+ 0.0	+ 0.4	- 0.2
Productivity per hour	+ 5.9	+ 4.3	+ 3.8	+ 8.4	+ 2.2	+ 3.5
Working hours per day for employee ⁴	- 0.1	+ 0.1	- 0.6	- 0.1	- 0.3	- 0.3

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

Firms had trimmed their investment plans already by mid-2001, according to the latest WIFO investment survey. Among the major demand components in the economy, capital spending on new machinery and equipment is the one being most cyclically sensitive and dependent on confidence factors. Uncertain prospects for sales and profits may induce firms to defer investment projects. The present projections assume for 2001 an increase in demand for machinery, vehicles, electronics and software by nearly 2 percent, accelerating to 3½ percent in 2002. However, the projected increase could quickly turn into an actual decline, should the international environment prove worse than anticipated.

In 2001, volume merchandise imports should advance at about the same pace as exports, by 4½ percent. Demand for imports of primary inputs is set to abate, as activity in the outward-oriented parts of the economy slackens. The same holds true for the demand for durable consumer goods, which have a high import content. Import prices, on the other hand, are accelerating, driven by unexpectedly high quotations on international oil markets. The deficit in the foreign trade balance could thus slightly exceed the level of ATS 83 billion or EUR 6 billion recorded last year.

In the tourism services balance, the surplus is expected to grow by about ATS 2 billion (EUR 0.15 billion) each in 2001 and 2002. Tourism revenues will go up markedly, by an inflation-adjusted 4½ percent, in 2001, the output of the corresponding sector by 3½ percent. The consequences of the terror assault and of any military response for international tourism are bound to be negative, but can hardly be quantified at the present stage. Austria as a safe destination may, however, benefit from a shift in demand, notably from European visitors. On the other hand, expenditure on travel is highly income-elastic, and households may be inclined to cut it more than proportionally in an adverse business cycle period. Austrian holidaymakers may increasingly opt for domestic desti-

Current account deficit broadly unchanged

nations, mainly at the expense of travel outside Europe. While domestic spending abroad is expected to remain flat, revenues from foreign visitors may still edge up.

The surplus in the balance on "other services" (transport services, software, consulting) is rising steadily, a trend that is set to continue with ever closer integration with the EU accession candidates in Eastern Europe. The income and transfer balances are in substantial deficit, albeit down somewhat from the levels recorded in 2000. In all, the current account deficit for 2001 is expected at ATS 76 billion (EUR 5.53 billion), slightly less than last year, and equivalent to 2½ percent of GDP.

In the second quarter, construction output fell by 5½ percent in volume from the year-earlier level. New-home building has been on a downward trend for some time, due to saturation of demand. The number of new dwellings completed could fall below 50,000 this year, some 10,000 less than over the period 1996-1999. Construction of new office space has boomed in the last years. Particularly in Vienna, the new capacity created this year is largely in excess of what longer-term projections have proposed as annual requirement. The resulting over-capacity suggests a substantial fall in the sector's output in the near future.

Road and railroad construction also fell in the second quarter, despite the fact that in both areas there is a clearly identified need for expansion. The improvement of transport infrastructure is not only a key determinant for the attractiveness of Austria as an investment location in the longer run, but also poses an immediate challenge in the context of EU enlargement. The slump in road construction is primarily due to the effort undertaken by the Federal States and municipalities to meet the target of a ATS 23 billion (EUR 1.67 billion) budget surplus agreed within the framework of a domestic Stability Pact. In the area of railroad construction, there are a number of projects ready to be carried out, but the start of actual construction works is being delayed by problems of co-ordination.

The fall in output has had severe repercussions on the labour market. Between January and August, construction employment was on average down by 11,000 or 4.3 percent from the year-earlier level, the number of jobseekers was 3,400 higher in August than a year ago. A further sharp rise in unemployment should be expected for the months to come.

On annual average, volume output is expected to fall by 3 percent. Under the circumstances prevailing, 2002 is unlikely to see a recovery, but rather a further decline by about 2 percent.

While a revival of demand for new residential and commercial buildings is being held back by existing large over-capacity, the slack in civil engineering could be taken up by policy action. If planned and much-needed infrastructure investment projects were carried forward, it would provide relief for overall activity and the labour market, without necessarily jeopardising longer-term budgetary targets.

Private households' real disposable income rose by a healthy 2.8 percent on average over the last three years. This allowed private consumption to grow by an annual 2.6 percent, and at the same time the saving ratio to edge up. In 2001, real disposable income is set to remain flat (-0.1 percent), while employees' real net earnings per capita are actually falling by 0.8 percent year-on-year. This is partly the result of lively inflation eating up most of wage and salary increases, and partly also of recent tax increases.

Experience shows that in a period of sluggish income growth households tend to react by saving less (as a proportion of disposable income). The forecast therefore assumes that the saving ratio will decline by almost 1½ percentage points this year. This assumption is certainly optimistic, although the private household saving ratio declined even more during the period of fiscal retrenchment in 1996-97. In the first six months of 2001, households increased their spending by 1.4 percent at constant prices, and a similar pace is expected for the latter part of the year. Outlays for durable consumer goods, having slipped in real terms in 2000, may still not pick up in the current year. One reason is that weak demand for new dwellings is dragging down also spending on new home equipment; another reason may be that in times of heightened uncertainty households tend to postpone big purchases.

In 2002, per-capita earnings are expected to rise by 2.6 percent (+3.1 percent on a full-time employee basis) which after tax should allow real purchasing power to be maintained at least. Real disposable income may go up by 1¾ percent, given the increase in transfer payments after the introduction of new child-care cash benefits. On this basis, private consumption may rise somewhat more than in 2001. However, should

The construction industry in crisis

Output of the construction sector has fallen drastically, because of existing over-capacities in residential building and lack of new orders for road and railroad construction. Unemployment is rising fast.

Lower saving ratio allows private consumption to grow

Relatively strong price increases and higher taxes are dampening the rise in personal disposable income in 2001. Assuming a decline in the share of income that households save, private consumption, adjusted for inflation, may rise by up to 1.5 percent. The contribution of the trade sector to GDP may edge up by 0.8 percent only.

households, unlike in the past, be unwilling to reduce their saving as foreseen, in the face of growing uncertainty, consumption could turn out significantly weaker than in the basic scenario, particularly in the second half of 2001 and the first half of next year.

Gross value added of the trade sector may edge up by 0.8 percent in real terms in 2001, only one-fourth of the rate recorded in 1999 and 2000. Wholesale trade is adversely affected by the sluggishness of exports and investment, while motor vehicle sales are shrinking. Retail sales, faring somewhat better, should pick up further next year.

Table 4: Private consumption, earnings and prices

	1997	1998	1999	2000	2001	2002
	Percentage changes from previous year, volume					
Private consumption expenditure	+ 1.4	+ 2.9	+ 2.3	+ 2.7	+ 1.5	+ 1.9
Durables	- 1.2	+ 7.0	+ 8.4	- 0.4	+ 0.5	+ 1.0
Non-durables and services	+ 1.7	+ 2.3	+ 1.4	+ 3.2	+ 1.6	+ 2.0
Household disposable income	- 1.1	+ 3.7	+ 1.7	+ 2.9	- 0.1	+ 1.8
Household saving ratio						
As a percentage of disposable income	7.3	8.1	7.8	8.0	6.6	6.7
	Percentage changes from previous year					
Direct lending to domestic non-banks ¹	+ 3.6	+ 3.7	+ 5.2	+ 6.7	+ 4.1	+ 4.7
	In percent					
Inflation rate						
All items	1.3	0.9	0.6	2.3	2.6	1.9
Core inflation ²	1.1	1.2	0.8	1.8	2.9	2.4

¹ End of period. – ² Excluding food and energy items.

Table 5: Earnings and international competitiveness

	1997	1998	1999	2000	2001	2002
	Percentage changes from previous year					
Gross earnings per employee ¹	+ 0.7	+ 3.0	+ 2.0	+ 2.2	+ 2.7	+ 2.6
Full-time equivalent	+ 1.3	+ 3.6	+ 3.0	+ 2.7	+ 3.2	+ 3.1
Gross real earnings per employee	- 0.8	+ 2.5	+ 1.2	+ 0.3	+ 0.1	+ 0.7
Net real earnings per employee	- 2.4	+ 2.3	+ 1.0	+ 0.8	- 0.8	+ 0.2
Net wages and salaries	- 0.3	+ 3.3	+ 3.7	+ 4.1	+ 2.1	+ 3.0
Unit labour costs						
Total economy	+ 0.2	+ 0.7	+ 0.9	+ 0.1	+ 1.9	+ 1.0
Manufacturing	- 4.4	- 1.7	- 0.5	- 6.0	+ 0.8	- 0.5
Relative unit labour costs ²						
Vis-à-vis trading partners	- 4.9	- 0.8	- 1.5	- 6.5	+ 0.5	- 0.5
Vis-à-vis Germany	+ 0.8	+ 0.4	- 0.1	- 2.6	- 0.4	- 0.9
Effective exchange rate – manufactures						
Nominal	- 1.8	+ 2.5	+ 0.6	- 2.7	+ 0.7	+ 0.6
Real	- 4.3	+ 0.5	- 1.3	- 3.5	+ 0.6	+ 0.3

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

The upward drift in consumer prices reached a peak in May 2001 with a year-to-year rise of 3.4 percent, but has abated since, to a rate of 2.5 percent in August. The effect of higher energy and motor vehicles taxes is no longer showing up in the annual rate, and the rise in energy prices has moderated. Still, higher energy costs are being passed onto prices of manufactures and services. Housing costs have also started heading up again.

The upcoming introduction of euro notes and coins has aroused concerns that the changeover could be taken as an occasion for widespread price increases. This, it is argued, would particularly concern goods and services, for which suppliers want to set prices in the new currency again at a round figure or just below such a round figure ("psychological" price-setting). WIFO is analysing current developments in the context of the monitoring exercise conducted by the "euro price commission". The findings, which also draw comparisons with Germany and Switzerland, have so far (until August) given

Inflation losing momentum

no indications for a wave of price rises induced by the imminent transition to the euro (see <http://www.wifo.ac.at/euromonitoring>).

The average rate of inflation for 2001 is projected at 2.6 percent, unchanged from last June. In 2002, food prices should no longer add to inflation. Forecasting energy prices is difficult at the present stage, given the critical international situation; the world market price for crude oil is held constant on annual average. Headline inflation would thus abate to a rate of 1.9 percent in 2002. Core inflation (excluding energy and food prices) would in both years slightly exceed the overall rate.

Table 6: Labour market

	1997	1998	1999	2000	2001	2002
	Changes from previous year, in 1,000					
<i>Demand for labour</i>						
Civilian employment	+ 8.8	+ 22.1	+ 32.2	+ 27.7	+ 15.2	+ 23.6
Excluding parental leave and military service	+ 13.3	+ 30.8	+ 38.2	+ 30.8	+ 13.9	+ 14.1
Dependent employment ¹	+ 8.3	+ 21.1	+ 31.2	+ 25.8	+ 13.2	+ 21.5
Excluding parental leave and military service	+ 12.8	+ 29.8	+ 37.2	+ 28.9	+ 11.9	+ 12.0
Percentage changes from previous year	+ 0.4	+ 1.0	+ 1.2	+ 1.0	+ 0.4	+ 0.4
Parental leave and military service ¹	- 4.4	- 8.7	- 6.0	- 3.1	+ 1.2	+ 9.5
Foreign workers	- 1.6	- 0.2	+ 7.8	+ 13.4	+ 9.1	+ 6.0
Self-employed ²	+ 0.5	+ 1.0	+ 1.0	+ 1.9	+ 2.0	+ 2.1
<i>Labour supply</i>						
Economically active population	(15 to 64) + 13.5	+ 11.0	+ 19.8	+ 25.2	+ 26.1	+ 22.9
	(15 to 59) + 20.3	+ 10.9	- 2.6	- 17.5	- 15.6	- 5.5
Total labour force	+ 11.7	+ 26.5	+ 16.2	+ 0.3	+ 20.1	+ 28.8
Excluding parental leave and military service	+ 16.1	+ 35.2	+ 22.2	+ 3.4	+ 18.9	+ 19.3
Foreign	- 1.7	+ 0.7	+ 6.6	+ 12.0	+ 13.0	+ 8.5
Migration of nationals	+ 5.4	+ 3.9	+ 3.0	- 3.0	- 1.0	+ 1.0
Indigenous	+ 8.0	+ 21.9	+ 6.6	- 8.7	+ 8.1	+ 19.3
Excluding parental leave and military service	+ 12.4	+ 30.6	+ 12.6	- 5.6	- 6.9	+ 9.8
<i>Surplus of labour</i>						
Registered unemployed ³	+ 2.8	+ 4.4	- 16.1	- 27.4	+ 5.0	+ 5.2
	in 1,000 233.3	237.8	221.7	194.3	199.3	204.5
Unemployment rate						
Percent of total labour force ⁴	in percent 4.4	4.5	4.0	3.7	3.8	3.8
Percent of total labour force ³	in percent 6.4	6.5	6.0	5.3	5.4	5.5
Percent of dependent labour force ³	in percent 7.1	7.2	6.7	5.8	6.0	6.1
Participation rate ⁵	67.2	67.6	67.6	67.3	67.4	67.6
Excluding parental leave and military service ⁶	70.2	70.7	71.2	71.5	72.1	72.6
Employment rate ⁷	62.9	63.2	63.6	63.8	63.8	63.9
Excluding parental leave and military service ⁶	65.6	66.1	66.9	67.7	68.2	68.5

¹ According to Association 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 upward trend in employment has flattened markedly in 2001. By August, the year-on-year gain (excluding people on parental leave and in regular military service) had come down to 12,000. The number of full-time jobs, which are predominantly held by men, is falling rapidly, while that of part-time posts keeps rising. Job cuts are deepest in the construction sector, in transport and telecommunications, and in the public service. Manufacturing, commercial services and the trade sector, on the other hand, still count more employees than a year ago. On annual average, the number of workers and employees is expected to rise by 12,000 or 0.4 percent above the total for 2000.

In several sectors, unemployment is rising along with employment. This is the case not only in trade and commercial services, but also in agriculture, hotels and restaurants, and in some branches of manufacturing. In the latter domain, the increase in administrative quotas for foreign seasonal workers plays an important role. In August, the number of jobseekers was already up by 15,000 from the level one year ago. In view of the cyclical downturn, a further substantial increase in unemployment should be expected in construction and a number of other sectors. The total of registered unemployed will average 200,000 this year, 5,000 more than in 1999. The figure corresponds to an unemployment rate of 3.8 percent of the labour force (Eurostat definition) and of 6.0 percent of the dependent labour force (national definition).

On the macro-economic assumptions underlying the forecast, employment should grow to about the same extent in 2002 as in the current year. New job creation will largely be

Unemployment rising markedly

The sharp deceleration of economic growth is holding back the creation of new jobs and causing a jump in unemployment. In 2002, the jobless ratio is poised to rise further.

confined to services. Labour supply will increase markedly, due mainly to higher labour force participation. While the population from 15 to 64 years of age is growing, that in the age bracket 15 to 59 years keeps receding. The number of unemployed may go up once again, to an annual average of 205,000.

The significant slowdown of real and nominal economic growth has consequences for the government households. Revenues from wage and from sales tax in 2001 are falling somewhat short of the draft budget figures, while spending on unemployment is rising noticeably. Retirement benefit expenditure is also higher than budgeted. Corporate tax revenues, on the other hand, are outstripping expectations, due to an excellent profit situation in 1999 and 2000, and interest payment obligations are somewhat lower than anticipated. The general government balance for 2001 could turn out somewhat weaker than projected by WIFO three months ago; nevertheless the deficit target ratio of 0.7 percent of GDP, as notified to the EU by the Ministry of Finance, will be met.

In 2002 also, the weaker business cycle will have an impact on public expenditure and revenue, albeit in some instances with a time lag. The Minister of Finance has announced the intention of fiscal policy to let automatic stabilisers work on the budget. From a macro-economic point of view, this decision is deemed appropriate. Taking into account the effect of the automatic stabilisers in the projected cyclical scenario, WIFO expects the general government balance in 2002 to be in deficit of around ATS 10 billion (EUR 0.74 billion), equivalent to 0.3 percent of GDP. No assumptions have been made as to possible options for fiscal policy to reduce the deficit. If policy were to use such options, care should be taken to avoid any further demand-depressing effects in the present critical stage of the business cycle. The carrying forward of public investment in infrastructure could provide timely support to overall economic activity, without necessarily leading to higher budget deficits in the medium term.

Effectiveness of automatic budgetary stabilisers

The business cycle slowdown is dampening the increase in tax revenue and requires additional public expenditure. In this way, the government budget exerts a stabilising influence on economic developments. The general government budget 2002 may exhibit a deficit of around ATS 10 billion (EUR 0.74 billion).

Table 7: Key policy indicators

	1997	1998	1999	2000	2001	2002
<i>Fiscal policy</i>						
			Billion ATS			
Central government net balance	- 71.9	- 79.7	- 67.7	- 38.9	- 38.0	- 29.0
			As a percentage of GDP			
Central government net balance	- 2.9	- 3.0	- 2.5	- 1.4	- 1.3	- 1.0
General government financial balance	- 1.9	- 2.4	- 2.2	- 1.1	- 0.7	- 0.3
General government primary balance	2.0	1.4	1.3	2.4	2.7	3.0
<i>Monetary policy</i>						
			In percent			
3-month interest rate	3.5	3.6	3.0	4.4	4.3	3.3
Long-term interest rate ¹	5.7	4.7	4.7	5.6	5.0	4.7
			Percentage changes from previous year			
<i>Effective exchange rate</i>						
Nominal	- 1.7	+ 2.8	+ 1.5	- 2.5	+ 0.8	+ 0.7
Real	- 4.6	+ 0.3	- 1.1	- 3.6	+ 0.5	+ 0.2

¹ 10-year central government bonds (benchmark).

Cut-off date: 26 September 2001