

Marcus Scheiblecker

## Euro Area in Temporary Recession

### Economic Outlook for 2012 and 2013

**The euro area economy is currently in recession. By the middle of the year, however, economic activity is expected to head up again, even if the recovery promises to be subdued given the fiscal restraint in many countries. While the export-oriented sector in Germany and Austria continues to receive stimulus from economies outside Europe, it will nevertheless be affected by sluggish euro area growth. Real GDP in Austria is likely to edge up by 0.4 percent in 2012. Growth in 2013 should strengthen to 1.4 percent, driven by foreign demand, but dampened by fiscal consolidation. The rise in oil prices will prevent a speedy decline in inflation.**

All staff members of the Austrian Institute of Economic Research contribute to the Economic Outlook. Data processing: Nora Popp, Roswitha Übl • Cut-off date: 27 March 2012. • E-mail address: [Marcus.Scheiblecker@wifo.ac.at](mailto:Marcus.Scheiblecker@wifo.ac.at)

Like on average in the euro area, business activity in Austria lost momentum during the course of the year 2011. Foreign demand slackened markedly and GDP receded slightly towards the end of the year. As results from Austrian business surveys suggest, the "soft patch" should soon be overcome and growth should resume as from the second quarter 2012. The rebound may nevertheless be muted as many EU governments press ahead with fiscal consolidation and firms as well as private households remain cautious on higher spending. Italy, Austria's second-most important trading partner, has announced sweeping budgetary cuts for this year which will likely lead to a decline in annual GDP. In Hungary, ranking 7th in Austria's export markets, activity will weaken substantially, too. Both developments will weigh on Austria's economic growth this year. In 2013, domestic fiscal policy will also turn more restrictive than anticipated in the forecast of last December, weighing further on the recovery. In this environment, real GDP will only increase by 1.4 percent.

Uncertainty on financial markets seems to have subsided somewhat since the end of 2011. In many euro area countries, long-term interest rates declined, Greece reached an agreement with its creditors and stock markets recorded a clear upward trend. Yet, the crisis in the banking sector does not appear to have been resolved, even if tensions have for now eased to some extent.

The renewed hike in oil prices due to geo-political tensions inhibits a speedy deceleration of inflation, despite the sluggishness of business activity. Domestic consumer prices are therefore projected to increase by 2.4 percent this year. Only in 2013 will the rate of inflation revert to an annual 2 percent.

The slackening of business activity will also be felt on the labour market. The unemployment rate is expected to rise from 6.7 percent in 2011 to 7.1 percent this year. GDP growth in 2013 will not suffice to turn the trend around, the jobless rate thus heading further up. Also the hitherto lively job creation will ease: the rate of employment growth in 2012 will drop by half from 2011 to 0.8 percent and further to 0.4 percent in 2013.

Both the OECD Leading Indicators and the Ifo Business Climate Index for the world economy point to a recent pick-up in business expectations which had been on a

**Worldwide business outlook brightening up**

downward trend since spring 2011. Thus, the slowdown in global economic activity should be overcome by the middle of 2012 at the latest.

This time, the driving force of the pick-up is less the emerging market economies of China, India or Brazil, but rather the USA, where GDP growth accelerated already during 2011; the industrial output index and incoming orders confirm the positive current situation. Leading Indicators like those from the OECD, the Purchasing Manager Index and both indices for consumer confidence suggest that the upward trend will continue in the near future.

*While the leading indicators for the world economy have signalled a cyclical weakening since spring 2011, they now point to an imminent recovery. Growth prospects for the US economy have improved markedly. In some key emerging markets business activity should rebound, although doubts remain about the sustainability of the stronger growth momentum.*

Table 1: Main results

		2008	2009	2010	2011	2012	2013	
		Percentage changes from previous year						
<b>GDP</b>								
Volume		+ 1.4	- 3.8	+ 2.3	+ 3.1	+ 0.4	+ 1.4	
Value		+ 3.2	- 2.8	+ 4.1	+ 5.3	+ 2.2	+ 2.9	
Manufacturing <sup>1</sup> , volume		+ 1.3	- 15.0	+ 7.2	+ 9.9	± 0.0	+ 3.5	
Wholesale and retail trade, volume		- 3.0	+ 0.7	+ 3.1	+ 0.1	+ 0.5	+ 0.8	
Private consumption expenditure, volume		+ 0.8	- 0.3	+ 2.2	+ 0.6	+ 0.8	+ 0.9	
<b>Gross fixed investment, volume</b>								
Machinery and equipment		+ 0.7	- 8.3	+ 0.1	+ 5.7	+ 1.1	+ 2.0	
Construction		- 0.7	- 9.7	+ 4.3	+ 11.3	+ 1.8	+ 3.5	
		+ 1.0	- 7.6	- 2.9	+ 2.6	+ 0.4	+ 0.6	
<b>Exports of goods<sup>2</sup></b>								
Volume		+ 0.5	- 16.8	+ 12.8	+ 7.5	+ 3.5	+ 6.5	
Value		+ 2.5	- 20.2	+ 16.7	+ 11.7	+ 4.0	+ 7.9	
<b>Imports of goods<sup>2</sup></b>								
Volume		+ 0.6	- 14.3	+ 10.3	+ 7.5	+ 3.7	+ 5.7	
Value		+ 4.7	- 18.4	+ 16.5	+ 15.1	+ 5.3	+ 7.8	
<b>Current balance</b>		billion €	+ 13.76	+ 7.49	+ 8.46	+ 5.20	+ 4.45	+ 5.84
As a percentage of GDP			+ 4.9	+ 2.7	+ 3.0	+ 1.7	+ 1.4	+ 1.8
Long-term interest rate <sup>3</sup>	in percent	4.4	3.9	3.2	3.3	2.9	2.9	
Consumer prices		+ 3.2	+ 0.5	+ 1.9	+ 3.3	+ 2.4	+ 2.0	
<b>Unemployment rate</b>								
Eurostat definition <sup>4</sup>	in percent	3.8	4.8	4.4	4.2	4.6	4.8	
National definition <sup>5</sup>	in percent	5.9	7.2	6.9	6.7	7.1	7.5	
Persons in active dependent employment <sup>6</sup>		+ 1.7	- 1.5	+ 0.8	+ 1.9	+ 0.8	+ 0.4	
<b>General government financial balance according to Maastricht definition</b>								
As a percentage of GDP			- 0.9	- 4.1	- 4.4	- 3.3	- 3.0	- 2.6

Source: WIFO Economic Outlook. – <sup>1</sup> Value added, including mining and quarrying. – <sup>2</sup> According to Statistics Austria. – <sup>3</sup> 10-year central government bonds (benchmark). – <sup>4</sup> According to Eurostat Labour Force Survey. – <sup>5</sup> According to Public Employment Service Austria, as a percentage of total labour force excluding self employed. – <sup>6</sup> Excluding parental leave, military service.

Once again, private household consumption proves to be the main driver of economic expansion in the USA. Already in 2011 it gained 2.2 percent in volume, thereby contributing 1.5 percentage points to overall GDP growth. Likewise, gross fixed investment climbed by a strong 6.7 percent in real terms in 2011, providing a growth contribution of 0.8 percentage points.

For US monetary and fiscal policy the present forecast assumes that the expansionary stance will be maintained at least throughout 2012. In 2011, the Federal Reserve left the key interest rate close to 0 percent for the third consecutive year and also continued its securities purchasing programme. The government extended fiscal stimulus measures beyond the turn of the year. The fiscal deficit declined only marginally in 2011 to slightly below 9 percent of GDP. In view of the upcoming presidential elections, an earlier fiscal policy turnaround appears unlikely.

Table 2: World economy

	2008	2009	2010	2011	2012	2013
	Percentage changes from previous year					
<i>Real GDP</i>						
World	+ 2.8	- 0.7	+ 5.2	+ 3.8	+ 3.4	+ 4.0
USA	- 0.3	- 3.5	+ 3.0	+ 1.7	+ 2.0	+ 2.3
Japan	- 1.0	- 5.5	+ 4.4	- 0.7	+ 1.4	+ 1.9
EU 27	+ 0.3	- 4.3	+ 2.0	+ 1.5	+ 0.1	+ 1.6
Euro area 16	+ 0.4	- 4.3	+ 1.9	+ 1.4	- 0.2	+ 1.3
Germany	+ 1.1	- 5.1	+ 3.7	+ 3.0	+ 0.5	+ 1.6
New EU countries <sup>1</sup>	+ 4.2	- 3.0	+ 2.5	+ 3.2	+ 1.8	+ 3.2
China	+ 9.6	+ 9.2	+ 10.4	+ 9.2	+ 8.2	+ 8.2
World trade, volume	+ 2.5	- 12.6	+ 14.9	+ 5.6	+ 5.0	+ 7.0
Market growth <sup>2</sup>	+ 2.9	- 11.5	+ 11.4	+ 7.5	+ 3.0	+ 6.0
<i>Primary commodity prices</i>						
HWI index, total	+ 32.7	- 34.7	+ 28.9	+ 28.6	+ 6	+ 3
Excluding energy	+ 18.7	- 28.4	+ 31.9	+ 19.2	± 0	+ 15
<i>Crude oil prices</i>						
Brent, \$ per barrel	97.0	61.5	79.5	111.3	120	120
<i>Exchange rate</i>						
\$ per euro	1.471	1.393	1.327	1.392	1.30	1.30

Source: WIFO Economic Outlook. – <sup>1</sup> Bulgaria, Czech Republic, Hungary, Latvia, Lithuania, Poland, Romania. – <sup>2</sup> Real import growth of trading partners weighted by Austrian export shares.

The recession of 2008-09 brought the widening of macroeconomic imbalances observed over many years only to a temporary halt. The US trade deficit (balance of goods and services), which had narrowed markedly during the recession of 2008, resumed its upward trend as early as from spring 2009. In 2011, the deficit rose to around \$ 560 billion, from \$ 500 billion in the previous year. With the pick-up in private consumption, the deficit could return to its pre-crisis peak. Consumer credit has also been rising in inflation-adjusted terms since autumn 2010 and is approaching its record high of 2008.

Figure 1: The US balance of foreign trade in goods and services

Balance, billion \$, seasonally adjusted



Source: BEA.

Real estate prices kept falling in 2011, undershooting the year-earlier level by 4 per cent at the end of the year. On the labour market, the gradual improvement is ongoing; nevertheless, the rate of unemployment in January and February 2012 still stood at 8.3 percent, only 1.7 percentage points down from the 10.0 percent peak of October 2009. Still, employment is heading up, as job creation has strengthened since autumn 2011.

Economic developments in Japan have in 2011 been determined by one-off factors, leaving the cyclical pattern unclear. Reconstruction works after the natural dis-

aster and its consequences of last spring led to a 1.7 percent increase in real GDP in the third quarter, followed however by another relapse by 0.2 percent in the subsequent period. For the whole year 2011, demand and output suffered a setback by almost 1 percent. Consumer prices stagnated despite the substantial increase in energy commodities. For the current year, WIFO expects Japanese GDP to rise by 1.4 percent and growth to accelerate to 1.9 percent in 2013.

The Chinese economy grew by 9.2 percent in 2011, somewhat less than in 2010. In the first half of the year, the pick-up in inflation and rising real estate prices pointed to cyclical overheating. As a reaction, monetary policy turned to a more restrictive stance. Towards the end of the year, however, the growth momentum slackened, prompting the Central Bank to loosen again the monetary reins. The government cut its official growth forecast for 2012 to 7.5 percent. In February, the Chinese trade balance showed for the first time a sizeable deficit of \$ 31 billion, as slower export growth was accompanied by a marked increase in import demand. Both the OECD Leading Indicators and the national official Purchasing Managers Index suggest a deceleration of growth in the near future. The WIFO projection is for annual GDP growth of 8.2 percent, both in 2012 and 2013.

Figure 2: China's merchandise trade balance

Goods, billion \$



Source: WTO.

The cyclical weakness in the euro area overshadows also demand and output performance in East-Central Europe. Apart from shortfalls in exports, more cautious credit extension due shortage of equity capital by banks operating in the area is weighing on domestic demand which during the past years has been a key engine of growth.

For 2012, WIFO projects real GDP growth to moderate to 1.8 percent. While demand and output are likely to stagnate in the Czech Republic and Hungary, they may expand by almost 3 percent in Poland. In 2013, the East-Central European economies should expand by a stronger 3.2 percent, thanks to a better international environment and a possible relaxation of credit standards.

In the last quarter of 2011, euro area real GDP edged down by 0.3 percent from the earlier period. As leading indicators signal a further decline of economic activity in early 2012, the area would again be in recession. Yet, unlike in the crisis of 2008-09, output losses are not primarily due to slackening foreign demand (countered by an expansionary fiscal stance), but partly to weak internal demand. Almost all euro area countries head at this critical juncture for a reduction of their government deficits. For the years to come they plan large-scale expenditure cuts and raise taxes to some extent. WIFO has already incorporated these foreseeable consolidation efforts in its projections of last December, implying a low growth forecast for the euro area and the EU at large. However, since latest consolidation plans of some countries have turned out more far-reaching than anticipated and appear more harmful to

### Loss of growth momentum also in East-Central Europe

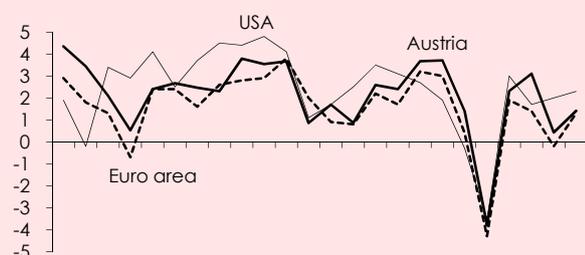
*In the new EU countries in eastern Europe GDP expanded by 3.2 percent in 2011, significantly more strongly than in the euro area.*

### Euro area economy again in short recession

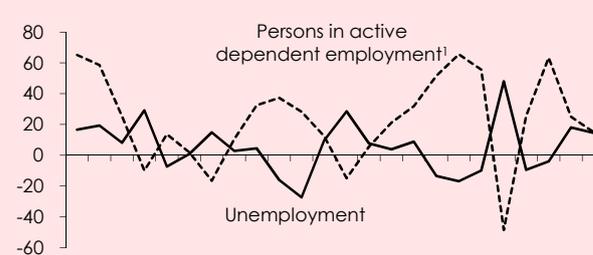
growth, the present revision foresees a decline of euro area GDP by 0.2 percent on annual average 2012. For the entire EU, GDP is expected to quasi-stagnate at +0.1 percent.

Figure 3: Indicators of economic performance

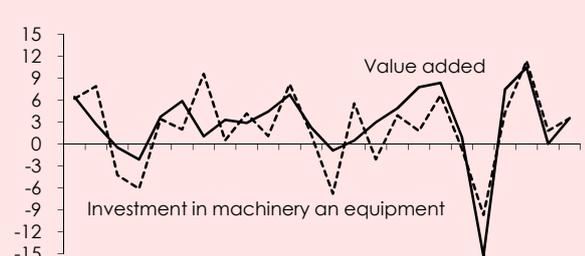
Growth of real GDP  
Percent



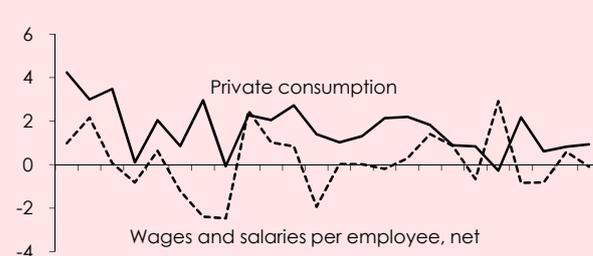
Employment and unemployment  
1,000 from previous year



Manufacturing and investment  
Percentage changes from previous year, volume



Consumption and income  
Percentage changes from previous year, volume



Short-term and long-term interest rates  
Percent



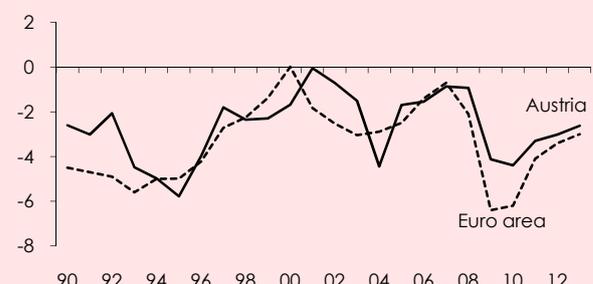
Inflation and unit labour costs  
Percentage changes from previous year



Trade  
Percentage changes from previous year, volume



General government financial balance  
As a percentage of GDP



Source: WIFO Economic Outlook. – <sup>1</sup> Excluding parental leave, military service, and unemployed persons in training. – <sup>2</sup> 10-year central government bonds (benchmark).

While in 2013 consolidation efforts are unlikely to be relaxed (some countries like Austria will even reinforce them), cyclical conditions outside Europe should improve as from late spring 2012 and provide some stimulus to economic activity. This should enable GDP to expand by 1.3 percent in the euro area in 2013 and by 1.6 percent in the EU overall.

Whereas fiscal consolidation turns out more stringent than originally assumed, uncertainty surrounding the sovereign debt crisis in the euro area appears to ease somewhat. The international community tied a second aid "package" to Greece to the condition of private sector involvement. In this regard, agreement on a debt "hair-cut" was reached with creditors in March.

In many euro area countries a decline in bond yields has been observed during the last few months. Thus, interest rates on 10-year government bonds eased between December 2011 and February 2012 by 1.6 percentage points to 7.0 percent in Ireland, by 0.5 percentage point to 5.1 percent in Spain and by 0.9 percentage point to 5.6 percent in Italy. In Portugal, the rate climbed at first, before moderating by 1 percentage point to 12.8 percent in February. The situation remains nevertheless unstable and bad news may rekindle uncertainty at any time.

While risks related to the sovereign debt crisis have abated somewhat for the time being, other factors are working towards a wider margin of forecast error:

- Oil prices keep rising swiftly due to geo-political tension (Iran). The implicit terms-of-trade losses would cause a substantial drain of purchasing power from the industrialised countries. Yet, private households may at the present juncture feel little inclined to maintain their spending levels at the expense of lower savings: first, oil price hikes are increasingly regarded as permanent, thus requiring an adjustment of consumer behaviour; second, fiscal consolidation already puts squeeze on disposable income and the private saving ratio.
- There are increasing indications of a flattening of trend growth in key emerging markets, like Brazil, India or China. However, this would not per se have a dampening impact on euro area exports. These countries have so far registered untypically high trade balances surpluses which could enable them to continue catching up economically and maintain their import ratios, accepting current account deficits as are typical for emerging market economies.
- A further forecasting uncertainty derives from EU-wide fiscal consolidation. Should it actually proceed as envisaged by the new fiscal governance framework, i.e., a reduction of the difference between the actual government debt ratio and the ceiling of 60 percent of nominal GDP by 1/20 per year, the contractionary effect on activity in the euro area and the EU would be substantially stronger than assumed for the present forecast.

Industrial output in the euro area has been heading down nearly everywhere within the euro area since September 2011; in December, the fall accelerated to -1.1 percent, before bottoming out to +0.2 percent in January. If production were to stagnate in February and March, the first quarter 2012 would see a decline of 0.6 percent from the previous period. After moving sideways for several months, the industrial confidence indicator for the euro area pointed tentatively up in February, which may presage an economic recovery as from the middle of the year. Likewise, manufacturing firms' output expectations signal a gradual improvement for the months to come.

With the cyclical weakening, labour market conditions deteriorated in the euro area. The number of people employed edged down by a seasonally-adjusted 0.2 percent from the previous period in both the third and fourth quarter 2011. At the same time, the unemployment rate kept rising, reaching 10.7 percent in January and up by 0.7 percentage points year-on-year. Of particular concern is the high rate of youth unemployment which stood at 21.6 percent in January, 1 percentage point higher than one year ago.

Inflation is gradually ebbing in the euro area. The annual increase in consumer prices narrowed to 2.7 percent in December and has been unchanged since, after having hovered around 3 percent between September and November 2011. The

*The euro area economy finds itself in an ambivalent situation: in a period of cyclical weakness, the member countries have committed themselves to a forceful consolidation of their government budgets. This will weigh further on economic growth, leading to a contraction of overall output in 2012.*

strongest upward pressure keeps emanating from energy costs due to higher oil prices. The price of one barrel of Brent Crude rose in February 2012 to around € 90 or \$ 120, surpassing on a euro basis even its peak of summer 2008 of € 85 (\$ 140).

Monetary policy is set to remain on an expansionary course for the foreseeable future. In December 2011 and in February 2012, the ECB supplied euro area banks with around € 500 billion each, for three years at a favourable interest rate, in order to prevent a potential credit crunch and to sustain demand for euro area government bonds. While many banks took advantage of this offer, they at the same time returned part of the funds as short-term deposits to the ECB. The total of these deposits rose to a record high above € 700 billion.

In line with the cyclical downswing in the EU, economic activity in Austria slackened during 2011. In the fourth quarter, demand and output even edged down by 0.1 percent from the previous period. In the euro area overall, real GDP fell at the same time by 0.3 percent.

In 2011, domestic activity received the strongest incentives from still lively capital formation. In particular investment in machinery and equipment expanded significantly, but also construction managed to turn around the negative trend of the past two years. The external sector added little to GDP growth as strong export gains of 6.7 percent in volume were accompanied by a 7.0 percent increase in real imports. Still, the net external growth contribution was positive, due to the relatively higher weight of exports.

According to the WIFO Business Cycle Survey, growth in Austria is about to resume. While the firms sampled saw an improvement in their current situation in January and February 2012, they reported a slight weakening in March. Also expectations for the next few months have turned more positive. After a likely stagnation in the first quarter 2012, GDP should increase as from the second quarter, although at a slower pace than in a typical upswing, due to the dampening effects of fiscal restriction at home and abroad.

### Austria: cyclical revival in the course of 2012

*At present, the international business cycle weakening is weighing on domestic activity. As from the middle of the year at the latest, the Austrian economy should again receive positive incentives from abroad. GDP growth will nevertheless remain subdued, at an annual average of 0.4 percent in 2012, picking up to 1.4 percent in 2013.*

Table 3: Productivity

	2008	2009	2010	2011	2012	2013
	Percentage changes from previous year					
<i>Total economy</i>						
Real GDP	+ 1.4	- 3.8	+ 2.3	+ 3.1	+ 0.4	+ 1.4
Employment <sup>1</sup>	+ 2.1	- 0.9	+ 0.8	+ 1.7	+ 0.9	+ 0.6
Productivity (GDP per employment)	- 0.7	- 2.9	+ 1.5	+ 1.4	- 0.5	+ 0.8
<i>Manufacturing</i>						
Production <sup>2</sup>	+ 0.9	- 15.3	+ 7.4	+ 10.4	± 0.0	+ 3.5
Employees <sup>3</sup>	+ 1.7	- 5.3	- 1.3	+ 1.9	- 0.8	- 0.2
Productivity per hour	- 0.3	- 7.3	+ 5.6	+ 8.2	+ 0.8	+ 3.4
Working hours per day per employee <sup>4</sup>	- 0.5	- 3.6	+ 3.0	+ 0.2	± 0.0	+ 0.3

Source: WIFO Economic Outlook. – <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.

Stimulus for exports will primarily be provided by demand from outside Europe. In particular the upswing in the USA should benefit the heavily export-oriented euro area economies like Germany and Austria. Even in a difficult environment these countries will therefore enjoy stronger economic growth than the rest of the euro area.

Adverse economic developments in 2012 are expected for Italy and Hungary. Italy, with a merchandise export share of 8 percent Austria's second-most important trading partner, will enter a recession due to the government's programme of fiscal retrenchment. Also Hungary (with a share of 3 percent of Austria's goods exports) faces severe problems in 2012, with internal demand set to decline on account of financing problems and budgetary cuts. Hardly any growth should thus be expected for the first half of the current year.

Against this background, WIFO expects Austria's real export growth to decelerate to 3.3 percent in 2012 (+3.5 percent for goods exports only). Exports of tourism services are projected to decline by 2 percent in volume, whereas other services exports may increase by 4.7 percent. In 2013, export growth should rebound to nearly 6 percent in volume (goods +6.5 percent; tourism services +2 percent).

The cyclical downturn will weigh on demand for investment goods this year. After a strong increase in firms' spending on new machinery and equipment (particularly on motor vehicles) by 11.3 percent in volume in 2011, the forecast is for a modest gain of 1.8 percent in 2012, followed by +3.5 percent in 2013.

While construction activity recovered in 2011 from the repercussions of the sharp recession of 2008-09, the outlook is for only modest growth in the next few years. Construction investment is expected to edge-up by an inflation-adjusted 0.4 percent this year, hardly gaining momentum in 2013 (+0.6 percent).

Already the revision of the WIFO forecast of last December had incorporated to some extent the fiscal consolidation efforts planned in Austria and in the euro area for 2012 and 2013. Meanwhile, many countries have submitted their plans in concrete terms (e.g., Austria in February 2012), which are more far-reaching than assumed in December.

The consolidation plans of the Austrian federal government provide for expenditure cuts of almost € 500 million or 0.15 percent of GDP in 2012. This relatively minor amount does not require an adjustment of the GDP forecast for the current year. In addition, tax revenues will be raised by € 1.2 billion (mainly by one-off items) which will hardly dampen growth. A much higher-than-anticipated consolidation amount of € 4 billion or 1¼ percent of GDP is planned for 2013. Only half of this amount will have a direct demand-dampening effect on private and public consumption or construction activity. Part of the reduction in demand will lead to lower imports without detracting from domestic output. Against this background, the forecast for GDP growth in 2013 has been taken down by 0.2 percentage points to a rate of 1.4 percent.

On the production side, these dampening effects will mainly show up in the sectors of trade, construction and public services; on the demand side, they will be mirrored in private and public consumption, construction investment and imports.

The difficulties facing banks in the euro area appear to have eased somewhat. Stock market values of financial institutions have rebounded since the beginning of 2012. In February, the ECB once more provided the banks with ample liquidity at a favourable interest rate. Still, a number of banks keep struggling with problems and have to resort to public support. In order to comply with the new "Basle III" regulation requiring system-relevant banks to raise their equity capital ratio to 9 percent by the middle of the year, some institutions may be tempted to cut their balance sheet total via restrictions on their outstanding credit volume. This would have, in spite of the current abundant liquidity supply, negative repercussions on investment and consumption and thus on economic growth.

In order to timely identify potential dangers for the domestic economy from that perspective, WIFO in its last business survey of February 2012 has asked domestic firms again for their assessment of possible credit constraints. Like in November 2011, three out of four firms sampled reportedly had no demand for credit at the time. However, 55 percent of the firms in need of credit declared that they had not obtained the funds at the conditions expected (in November 2011: 45 percent). The share of firms which against expectations did not obtain credits, did not rise significantly (from 20 percent to 24 percent). Thus, while a gradual deterioration in access to credit can be observed, this should not go beyond the normal pattern observed during a cyclical downturn and cannot be taken as evidence for an actual or looming credit crunch.

WIFO expects for 2012 and 2013 interest rates for 3-months interbank loans of 1.1 percent and 1.5 percent respectively, slightly above the current ECB key interest

*The government measures to consolidate public finances will reduce GDP growth by 0.5 percentage points in 2013.*

**No signs of an imminent credit crunch**

rate of 1 percent. In such circumstances, domestic credit should expand at moderate rates of 2.5 percent (2012) and 2.7 percent (2013).

Inflation is subsiding unexpectedly slowly. After a marked increase with the recovery from the deep recession, crude oil prices have been gradually easing since spring 2011, while still maintaining a strong year-on-year increase. This is mirrored by the profile of domestic inflation: headline inflation mounted quickly to 3.6 percent last September, before abating to 3.2 percent in December and further to 2.8 percent in January and 2.6 percent in February. For the first time since December 2010, the Austrian year-on-year consumer price increase has now fallen below the euro area average.

### Inflation receding only slowly

*The renewed hike in quotations for crude oil prevents a swift decline in inflation. In euro terms, the oil price in February 2012 even exceeded the peak reached in 2008.*

Table 4: Private consumption, income and prices

	2008	2009	2010	2011	2012	2013
	Percentage changes from previous year					
Private consumption expenditure	+ 0.8	- 0.3	+ 2.2	+ 0.6	+ 0.8	+ 0.9
Durables	+ 3.7	+ 0.9	+ 5.8	+ 0.9	- 0.5	+ 0.3
Non-durables and services	+ 0.5	- 0.4	+ 1.8	+ 0.6	+ 0.9	+ 1.0
Household disposable income	+ 0.9	- 1.7	- 0.3	+ 0.2	+ 0.7	+ 1.0
	As a percentage of disposable income					
Household saving ratio <sup>1</sup>	11.5	10.7	8.3	7.5	7.3	7.4
Household saving ratio <sup>2</sup>	11.4	10.1	7.8	7.4	7.3	7.4
	Percentage changes from previous year					
Direct lending to domestic non-banks <sup>3</sup>	+ 7.4	- 1.3	+ 2.9	+ 2.6	+ 2.5	+ 2.7
	Percentage changes from previous year					
Inflation rate						
National	3.2	0.5	1.9	3.3	2.4	2.0
Harmonised	3.2	0.4	1.7	3.6	2.5	2.1
Core inflation <sup>4</sup>	2.4	1.5	1.2	2.8	2.4	2.0

Source: WIFO Economic Outlook. – <sup>1</sup> Including adjustment for the change in net equity of households in pension fund reserves. – <sup>2</sup> Excluding adjustment for the change in net equity of households in pension fund reserves. – <sup>3</sup> End of period. – <sup>4</sup> Excluding unprocessed food (meat, fish, fruits, vegetables) and energy items.

Table 5: Earnings and international competitiveness

	2008	2009	2010	2011	2012	2013
	Percentage changes from previous year					
Gross earnings per employee <sup>1</sup>	+ 3.2	+ 1.6	+ 1.2	+ 2.7	+ 3.2	+ 2.2
Gross real earnings per employee <sup>2</sup>	- 0.0	+ 1.1	- 0.6	- 0.5	+ 0.8	+ 0.2
Net real earnings per employee <sup>2</sup>	- 0.7	+ 2.9	- 0.8	- 0.8	+ 0.6	- 0.1
<i>Total economy</i>						
Unit labour costs	+ 3.7	+ 4.7	- 0.3	+ 1.2	+ 3.6	+ 1.3
<i>Manufacturing</i>						
Unit labour costs	+ 5.2	+ 15.1	- 5.7	- 4.5	+ 3.2	- 1.3
Effective exchange rate, manufactures						
Nominal	+ 1.1	+ 0.7	- 2.6	+ 0.0	- 0.8	- 0.1
Real	+ 0.6	+ 0.4	- 2.7	+ 0.7	- 0.7	± 0.0

Source: WIFO Economic Outlook. – <sup>1</sup> Employees according to National Accounts definition. – <sup>2</sup> Deflated by CPI.

With the rising geo-political tensions (Iran), commodity prices have again been heading up recently, suggesting that the deceleration of inflation will lose momentum. WIFO expects for 2012 an annual average inflation rate of 2.4 percent. Under the technical assumption of constant oil prices and exchange rates to the dollar over the forecast horizon, annual inflation will further moderate to 2.0 percent in 2013.

The persistence of inflation will hold back gains in real earnings. Nevertheless, per-capita wages and salaries are expected to increase by an inflation-adjusted 0.8 percent in 2012 and a further small 0.2 percent in 2013. Some expected decline in the saving ratio will allow private households to step up consumption by 0.8 percent and thus more than in 2011, thereby contributing to cyclical stabilisation. With a projected increase of 0.9 percent, consumption would maintain its steady upward trend in 2013.

Despite the slackening of economic activity, employment kept rising throughout 2011. At the end of the year, the number of persons in dependent active employment was higher by 61,200 or 1.9 percent than one year ago. Likewise, the annual average increase from 2010 was 63,300 or 1.9 percent. New jobs were created not only in services, but also in manufacturing.

As usual in periods of cyclical upswing, labour supply expanded in 2011. In addition, access to the domestic labour market was entirely liberalised for several East-central European countries, thereby adding to growing labour supply as from last May.

### Employment and unemployment both increase

Due to an increase in labour supply, both employment and the jobless ratio will move up in 2012 and 2013.

Table 6: Labour market

		2008	2009	2010	2011	2012	2013
		Changes from previous year, in 1,000					
<i>Demand for labour</i>							
Persons in active employment <sup>1</sup>		+ 66.0	- 44.0	+ 31.3	+ 70.5	+ 30.0	+ 20.0
Employees <sup>2</sup>		+ 55.6	- 48.5	+ 25.5	+ 63.3	+ 25.0	+ 15.0
<i>Percentage changes from previous year</i>		+ 1.7	- 1.5	+ 0.8	+ 1.9	+ 0.8	+ 0.4
Nationals		+ 31.1	- 43.0	+ 5.8	+ 25.7	+ 10.0	+ 6.0
Foreign workers		+ 24.5	- 5.5	+ 19.7	+ 37.7	+ 15.0	+ 9.0
Self-employed <sup>3</sup>		+ 10.4	+ 4.5	+ 5.8	+ 7.2	+ 5.0	+ 5.0
<i>Labour supply</i>							
Population of working age	15 to 64 years	+ 27.7	+ 17.3	+ 21.6	+ 32.8	+ 15.0	+ 6.7
	15 to 59 years	+ 17.6	+ 11.1	+ 8.9	+ 16.8	+ 14.7	+ 10.8
Labour force <sup>4</sup>		+ 56.0	+ 4.0	+ 21.8	+ 66.4	+ 48.0	+ 34.5
<i>Surplus of labour</i>							
Registered unemployed <sup>5</sup>		- 10.0	+ 48.1	- 9.5	- 4.1	+ 18.0	+ 14.5
In 1,000		212.3	260.3	250.8	246.7	264.7	279.2
Unemployed persons in training <sup>5</sup>	in 1,000	50.5	64.1	73.2	63.2	65.2	68.2
In percent							
<i>Unemployment rate</i>							
Eurostat definition <sup>6</sup>		3.8	4.8	4.4	4.2	4.6	4.8
As a percentage of total labour force <sup>5</sup>		5.3	6.5	6.2	6.0	6.4	6.7
National definition <sup>5,7</sup>		5.9	7.2	6.9	6.7	7.1	7.5
<i>Employment rate</i>							
Persons in active employment <sup>1,8</sup>		65.7	64.7	65.0	65.9	66.3	66.5
Total employment <sup>6,8</sup>		72.1	71.6	71.7	72.2	72.5	72.6

Source: WIFO Economic Outlook. – <sup>1</sup> Excluding parental leave, military service. – <sup>2</sup> According to Federation of Austrian Social Security Institutions. – <sup>3</sup> According to WIFO. – <sup>4</sup> Persons in 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> As a percentage of total labour force, excluding self-employed. – <sup>8</sup> As a percentage of population of working age (15 to 64 years).

In 2012, with the slower pace of activity, job creation will lose momentum. The number of persons in dependent active employment is set to increase by 25,000 or 0.8 percent. Job gains will become still smaller in 2013 (+15,000 or +0.4 percent) despite the expected recovery of demand and output growth.

With job creation still unabated, registered unemployment started heading up towards the end of 2011. At the same time, however, enrolment in job-training programmes fell markedly. In December, 2,500 more persons were registered as unemployed than one year ago, corresponding to a seasonally-adjusted increase of 5,500 from November, while the number of job trainees fell by almost 5,500. In January and February, the rise in unemployment accelerated, with enrolment in job training also picking up. For the whole of 2012, WIFO expects an increase in unemployment by 18,000; the jobless rate will ratchet up from 6.7 percent to 7.1 percent (na-

tional definition). Prospects for 2013 are for a further increase in registered unemployment by 14,500 to a rate of 7.5 percent of the dependent labour force.

### *Methodological Notes and Short Glossary*

#### *Period comparisons*

Time-series comparisons with the previous period, e.g., the previous quarter, are adjusted for seasonal effects. They also include effects that result from a different number of working days in the period (e.g., Easter). In the text, reference is made to "seasonally and working day adjusted changes".

The phrase "changed compared with a year before . . .", on the other hand, describes a change compared with the same period a year before and refers to unadjusted time series.

The analysis of the seasonally and working day adjusted development provides more precise information about the actual course of economic activity and shows turning points sooner. However, the data are subject to additional revisions as seasonal adjustment is based on statistical methods.

#### *Average rates of change*

The time given refers to the initial and the final value of the period of computation: hence the average rate 2005-2010 comprises as the first rate of change that from 2005 to 2006, and as the last that from 2009 to 2010.

#### *Real and nominal values*

In principle, the values shown must be understood as real values, i.e., adjusted for price effects. Whenever values are shown as nominal values (e.g., foreign trade statistics), this is specifically mentioned.

#### *Production Sector*

This term comprises the NACE-2008 sections B, C and D (Mining and Quarrying, Manufacturing, Energy Supply) and is here used in an international comparison.

#### *Inflation, CPI und HICP*

The inflation rate measures changes in consumer prices compared with a year before. The Consumer Price Index (CPI) is a measure of national inflation. The Harmonised Index of Consumer Prices (HICP) is the basis for comparable measurement of inflation in the EU and for the evaluation of price stability in the euro area (see <http://www.statistik.at/>).

Core inflation as a monetary policy indicator is not clearly defined. WIFO follows the common practice of using the inflation rate excluding the product categories unprocessed food and energy for core inflation. Thus just under 87 percent of the goods and services contained in the consumer price index (CPI 2010) are included in the calculation of core inflation.

#### *WIFO Business Cycle Survey and WIFO Investment Survey*

The WIFO Business Cycle Survey is a monthly survey in which around 1,100 Austrian firms are asked to assess their current and future economic situation. The WIFO Investment Survey is conducted twice a year, asking companies about their investment activity (<http://www.ikt.at/>). The indicators are balances between the positive and negative responses expressed as a percentage of the total number of firms sampled.

#### *Unemployment rate*

Austrian national definition: The number of persons registered as job seekers with the Public Employment Service expressed as a percentage of the dependent labour force. Labour force is the sum of the unemployed and the persons in dependent employment (measured in standard employment relationships). Database: registrations with the Public Employment Service (AMS) and Association of Austrian social insurance agencies.

Definition according to ILO and EUROSTAT: Any person who is not gainfully employed and is actively seeking work is considered unemployed. Gainfully employed persons comprise all persons who during the reference week worked for at least one hour in a self-employed capacity or in paid employment. Persons receiving child-care benefit and apprentices are classified as gainfully employed, whereas persons in military service or persons carrying out alternative service are not. The unemployment rate is the number of unemployed persons expressed as a percentage of the total labour force (unemployed persons plus gainfully employed persons). Database: data from household surveys ("Mikrozensus").

#### *Terms used in connection with the national definition of the unemployment rate*

Persons in training: Persons who at a set date are enrolled in AMS (Public Employment Service) training programmes. When calculating the unemployment rate, their number is not taken into account either in the denominator or in the numerator.

Persons in dependent active employment: "Persons in dependent employment" include persons receiving child-care benefit, as well as persons in military service or persons carrying out alternative service with a valid employment contract. By deducting their number one arrives at the number of "persons in dependent active employment".

The Austrian programme for the consolidation of public finances foresees budgetary savings of nearly € 500 million in 2012 and an overall deficit reduction of € 1.7 billion. For 2013, the consolidation amount is planned to rise to € 4 billion. Thereby, a narrowing of the deficit will be achieved in both years, despite the weakness in business conditions. According to the latest data published by Statistics Austria after this forecast, the general government deficit fell 2011 to 2.6 percent of nominal GDP. In 2012, the deficit ratio is forecasted to decline somewhat and be reduced in 2013 further by half a percentage point. This projection includes several elements of uncertainty, such as additional funds needed for the rescue of domestic banks or a number of anticipated revenues (advance payment for the withholding tax of hitherto untaxed Austrian deposits in Switzerland, ex-ante taxation of disbursements of pension funds).

## Stepwise fiscal consolidation

*The measures submitted by the federal government to restore the balance in public finances will reduce the deficit in 2012 and 2013 despite the weakening of business activity.*

Table 7: Key policy indicators

	2008	2009	2010	2011	2012	2013
	As a percentage of GDP					
<i>Fiscal policy</i>						
General government financial balance						
According to Maastricht definition	- 0.9	- 4.1	- 4.4	- 3.3	- 3.0	- 2.6
According to National Accounts	- 1.0	- 4.1	- 4.4	- 3.3	- 3.0	- 2.6
General government primary balance	+ 1.7	- 1.3	- 1.7	- 0.6	- 0.3	+ 0.1
	Percent					
<i>Monetary policy</i>						
3-month interest rate	4.6	1.2	0.8	1.4	1.1	1.5
Long-term interest rate <sup>2</sup>	4.4	3.9	3.2	3.3	2.9	2.9
	Percentage changes from previous year					
<i>Effective exchange rate</i>						
Nominal	+ 1.2	+ 0.9	- 2.5	+ 0.1	- 0.8	± 0.0
Real	+ 0.6	+ 0.4	- 2.7	+ 0.7	- 0.7	± 0.0

Source: WIFO Economic Outlook. – <sup>1</sup> 10-year central government bonds (benchmark).