

EWALD WALTERSKIRCHEN

# BUSINESS CYCLE RECOVERY DELAYED

## ECONOMIC OUTLOOK FOR 2002 AND 2003

The Austrian economy is set to grow by slightly less than 1 percent this year and by over 2 percent in 2003. The risks surrounding the recovery of the business cycle, to which WIFO had pointed in its forecast of last June, have materialised. The slide in stock market values has undermined consumer and business confidence world-wide. Given the degree of uncertainty and the weaker sentiment, growth prospects have to be revised downwards. Sluggish activity is being reflected in a marked rise in unemployment and in budget deficits exceeding initial targets.

All staff members of the Austrian Institute of Economic Research contribute to the Economic Outlook. E-mail address: [Ewald.Walterskirchen@wifo.ac.at](mailto:Ewald.Walterskirchen@wifo.ac.at) • Cut-off date: 25 September, 2002

Since last July, the business outlook for the USA and for Europe has deteriorated<sup>1</sup>. The sharp fall on stock markets has negative repercussions also on the real economy via financial wealth losses and growing market pessimism. According to business survey results and forward-looking indicators, demand and output will move at a slower pace than expected. Projections for Europe are more in need of correction than those for the USA, given the particularly disappointing recent performance of the EU economy. This has implications not only for Austrian export prospects, but also for companies' investment plans.

Until mid-year, the recovery in Austria proceeded as expected. Real GDP gained about ½ percent from quarter to quarter. Then, in summer, business confidence weakened. Expectations for the coming months were revised, reflecting doubts about the robustness of activity in the USA as well as the slump on stock markets. Not yet included in the survey results were the consequences of the floods; the associated shortfalls in production came as an additional negative, albeit short-lived, factor.

Because of the delay in the recovery, the WIFO growth projection for 2002 that had been kept unchanged since last December, has to be taken down by ¼ percentage point to a rate of 0.9 percent. This has implications also for next year, as the pace of the recovery will be slower than expected so far. GDP growth in 2003 is revised down by ½ percentage point to a rate of 2.2 percent. This scenario assumes that the standstill of the recovery will be overcome and the upward trend will resume next year. It is supported by the argument that confidence in stock-exchange listed companies should gradually return and that the backlog in deferred investment will unwind, if only to meet the need for replacement. The persistent low level of interest rates and the fiscal investment premium offer incentives in this regard.

The recovery nevertheless remains subject to considerable risks. In the USA, business activity still has to pass the test of robustness. A war against Iraq would send oil prices to new hikes and drive stock markets down even further. In the EU, some larger countries are faced with the need to take restrictive fiscal policy action in the current period of sluggishness, in order to comply with the obligations of the Stability and Growth Pact.

In Austria, growth has been supported largely by net exports. Because of weak domestic demand, notably for investment goods, merchandise imports will fall by 3 percent in volume. The current account deficit will thereby be cut in half.

The sharp fall in investment, with an annual decline of 5 percent now lasting for two years, together with a steep rise in unemployment, has prompted the federal government to present a "package" to stimulate growth and employment. A 10 percent investment

<sup>1</sup> See Kramer, H., Budgetpolitik und wirtschaftspolitische Strategie, WIFO, Vienna, August 2002, [http://titan.wsr.ac.at/wifosite/wifosite.get\\_abstract\\_type?p\\_language=2&pubid=22581&pub\\_language=-1&p\\_type=0](http://titan.wsr.ac.at/wifosite/wifosite.get_abstract_type?p_language=2&pubid=22581&pub_language=-1&p_type=0).

premium granted up to the end of 2003 shall encourage firms to carry investment plans forward.

Table 1: Main results

		1998	1999	2000	2001	2002	2003
		Percentage changes from previous year					
GDP							
Volume		+ 3.5	+ 2.8	+ 3.0	+ 1.0	+ 0.9	+ 2.2
Value		+ 4.1	+ 3.5	+ 4.2	+ 2.7	+ 2.1	+ 3.6
Manufacturing <sup>1</sup> , volume		+ 4.4	+ 3.4	+ 7.3	+ 0.9	+ 1.0	+ 3.5
Private consumption expenditure, volume		+ 2.8	+ 2.7	+ 2.5	+ 1.4	+ 1.0	+ 1.8
Gross fixed investment, volume		+ 3.4	+ 1.5	+ 5.1	- 3.4	- 2.8	+ 2.8
Machinery and equipment <sup>2</sup>		+ 6.4	+ 4.3	+ 11.1	- 5.2	- 5.0	+ 4.5
Construction		+ 1.3	- 0.7	+ 0.3	- 1.7	- 1.0	+ 1.5
Exports of goods <sup>3</sup>							
Volume		+ 8.1	+ 7.7	+ 13.1	+ 5.4	+ 3.0	+ 6.0
Value		+ 8.4	+ 7.0	+ 15.6	+ 6.5	+ 3.2	+ 7.1
Imports of goods <sup>3</sup>							
Volume		+ 7.1	+ 6.9	+ 10.9	+ 2.8	- 3.0	+ 6.5
Value		+ 6.6	+ 6.7	+ 14.7	+ 5.0	- 2.8	+ 7.6
Current balance	billion €	- 4.68	- 6.33	- 5.35	- 4.65	- 1.83	- 1.67
As a percentage of GDP	in percent	- 2.5	- 3.2	- 2.6	- 2.2	- 0.9	- 0.7
Long-term interest rate <sup>4</sup>	in percent	4.7	4.7	5.6	5.1	5.0	4.7
Consumer prices		+ 0.9	+ 0.6	+ 2.3	+ 2.7	+ 1.8	+ 1.4
Unemployment rate							
Percent of total labour force <sup>5</sup>	in percent	4.5	3.9	3.7	3.6	4.1	4.1
Percent of dependent labour force <sup>6</sup>	in percent	7.2	6.7	5.8	6.1	6.9	6.9
Dependent employment <sup>7</sup>		+ 1.0	+ 1.2	+ 1.0	+ 0.4	- 0.4	+ 0.4
General government financial balance according to Maastricht definition							
As a percentage of GDP	in percent	- 2.4	- 2.3	- 1.5	+ 0.2	- 1.5	- 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. – <sup>6</sup> According to Labour Market Service. – <sup>7</sup> Excluding parental leave and military service.

The measures taken so far by the federal and the state governments to stimulate the economy, as well as repair works after the floods, will help sustain construction activity, particularly in civil engineering. The projection for construction output is adjusted from -2 to -1 percent. In 2003, construction output should edge up as renovation of structures damaged by the floods continues. Private consumption, adjusted for inflation, has so far maintained the year-earlier level. However, car purchases and private residential investment have taken a steep fall.

The cyclical weakness has led to shortfalls in tax revenues of about € 2 billion this year. To this should be added the budgetary burden of € 1 billion induced by the flood damages. The general government household for 2002 will thereby exhibit a deficit of around 1½ percent of GDP. Government expenditure (excluding flood aid and unemployment benefits) hardly deviates from budgetary targets. For 2003, the deficit is projected at slightly above 1 percent of GDP, provided the recovery proceeds as expected.

The slowdown of economic growth is causing an unusually sharp increase in unemployment (+31,000), one of the highest among EU countries in 2002. As expected, demand for labour slackened, but at the same time labour supply was boosted by the raise in the early retirement age and by the generous granting of work permits for foreign seasonal workers. The rate of unemployment will therefore go up from 6.1 percent (2001) to 6.9 percent this year, staying at a high level in 2003. The Federal government's cyclical stimulus "package" comes rather late in preventing the deterioration of job opportunities for the young. The measures in the context of the "youth safety net" (Jugendauffangnetz) have been extended, the apprenticeship promotion reinforced.

Overall inflation is projected to decelerate. Consumer prices are set to rise by 1.8 percent on annual average 2002, 1 percentage point less than in 2001 owing to a

stabilisation of energy prices. A further decline to a rate of 1.4 percent may be expected for 2003, as the next wage round in the private sector should result in lower settlements than the previous one and a number of irregular factors such as price hikes for seasonal goods, will wear off.

Since last summer, the international business cycle outlook has deteriorated. Business surveys and leading indicators point to weak economic activity in the USA and in Europe. The slump on financial markets and the fragility of consumer sentiment seem to reinforce each other. Stock market values continued to fall until September, with the decline not being confined to the IT sector, but extending to large parts of the economy. Doubts about firms' compliance with accounting rules as well as about the sustainability of the upturn in the USA were the major reasons. Together with the decline, stock markets turned more volatile, an indicator of heightened uncertainty. Although the actual situation is better than suggested by the dramatic developments on stock markets, the latter nevertheless have a strong impact on the real economy via financial wealth losses and confidence effects; besides, share prices are seen as an indicator of economic developments in the near future.

Real estate prices rose substantially in a number of countries, notably in the USA, while bond yields declined, reflecting portfolio shifts from equities towards real estate, bonds and near-money-market financial instruments. Rising housing prices and low mortgage rates provided incentives for residential construction in the USA.

### Business cycle upturn in the USA jeopardised

Table 2: World economy

	1998	1999	2000	2001	2002	2003	
	Percentage changes from previous year						
<i>Real GDP</i>							
Total OECD	+ 2.8	+ 3.2	+ 3.8	+ 0.8	+ 1.3	+ 2.3	
USA	+ 4.3	+ 4.1	+ 3.8	+ 0.3	+ 2.3	+ 2.6	
Japan	- 1.1	+ 0.7	+ 2.4	- 0.2	- 1.0	+ 1.0	
EU	+ 2.9	+ 2.8	+ 3.5	+ 1.6	+ 1.0	+ 2.3	
Euro area	+ 2.9	+ 2.7	+ 3.5	+ 1.5	+ 0.8	+ 2.2	
Germany	+ 2.0	+ 2.0	+ 2.9	+ 0.6	+ 0.5	+ 1.8	
Central and Eastern Europe <sup>1</sup>	+ 3.6	+ 3.2	+ 3.9	+ 2.3	+ 1.5	+ 2.8	
<i>World trade, volume</i>							
OECD exports	+ 5.6	+ 6.0	+ 12.7	+ 0.3	+ 3.5	+ 7.0	
OECD imports	+ 5.7	+ 5.7	+ 12.0	- 0.8	+ 2.0	+ 7.5	
Intra-OECD trade	+ 8.3	+ 7.8	+ 11.4	- 1.4	+ 1.5	+ 5.5	
<i>Market growth<sup>2</sup></i>	+ 11.3	+ 7.4	+ 12.8	+ 2.2	+ 2.0	+ 5.5	
<i>Primary commodity prices, in US\$</i>							
HWWA index, total, 1990 = 100	- 22.0	+ 12.0	+ 31.0	- 11.0	+ 2.0	+ 2.0	
Excluding energy	- 13.0	- 8.0	+ 1.0	- 7.0	- 3.0	+ 3.0	
<i>Crude oil prices</i>							
Average import price (cif) for OECD countries	US\$ per barrel	12.6	17.3	28.0	23.5	24.5	25.0
<i>Exchange rate</i>	US\$ per ECU or €	1.121	1.067	0.924	0.896	0.94	1.00

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

US economic growth in the last two years has been revised down. A recession during the first three quarters 2001 was followed by a strong six months rebound which, however, levelled off in the second quarter 2002, when GDP rose by a disappointing 1.1 percent seasonally-adjusted annualised rate. Retail sales figures for July suggested lively consumer demand for the third quarter. Nevertheless, stock market losses, the high indebtedness of private households and fragile labour market conditions could dampen consumption in the months to come. By contrast, the slump in investment in machinery and equipment may come to an end, as indicated by the most recent order figures. Stockbuilding should also provide incentives to growth.

Over the last weeks, the leading forecasting institutes have cut their growth estimates for the US economy. WIFO now expects a rate between 2 and 2½ percent for 2002 and 2½ to 2¾ percent next year.

Activity in Japan strengthened markedly in the first semester, driven by rising net exports and stockbuilding, while private consumption remained sluggish. Despite the pick-up

observed, the Japanese economy will again see slightly negative growth for the year as a whole. A moderate expansion of 1 percent may be expected for 2003.

Latin America is still under the impression of the crisis in Argentina and its repercussions. In Brasil, confidence in politics and the state of public finances is dwindling. Since the beginning of the year, the "real" has depreciated by about one quarter vis-à-vis the dollar, and yields on government bonds have increased substantially. In Argentina, the situation remains precarious.

In the euro area, economic developments this year fell short of expectations. Real GDP rose by 0.4 percent from the previous period in the first and by 0.3 percent in the second quarter. The recovery was primarily brought about by an increase in net exports: exports to non-EU countries increased, while imports declined under the impact of weak internal demand. Private households' propensity to consume was subdued, partly as a reaction to high unemployment and to uncertainty related to the changeover to the euro. Investment was also more sluggish than anticipated.

Economic policy in Europe is geared mainly towards stability. The key policy assumption in the EU, whereby low inflation and budgetary consolidation will more or less by themselves generate solid economic growth, has not been confirmed so far. The performance of the European economy is lagging noticeably behind that of the USA, not only in a longer perspective, but also in the current year, although the US economy has been particularly affected by the losses in stock market wealth and the consequences of corporate balance sheet manipulations. In the first half of 2002, activity in the USA rose by 1.8 percent from last year, in the EU by a mere ½ percent. The more pragmatic, problem-oriented policy approach followed by the USA appears at present to be superior to the more rules-based stance in the EU.

Last summer, the forward-looking cyclical indicators pointed to a deceleration of the already timid recovery in Europe. On annual average 2002, the EU economy is set to grow by only 1 percent, and by 2 to 2½ percent next year.

Despite growth being anaemic, no expansionary incentives should currently be expected from economic policy in the EU. The ECB is likely to keep interest rates unchanged for the time being, the envisaged raise having become obsolete with the sudden cyclical reversal. Before the summer, the debate has been about shifting from an expansionary towards a more neutral monetary stance; with the relapse of activity, expectations are rather for lower interest rates.

Cyclical risks are deriving also from the conduct of budgetary policy in the EU. Sluggish activity is leading to shortfalls in public revenues and a considerable widening in budget deficits. In the euro area, the latter are 1 to 1½ percentage points higher than expected. Several large EU countries (Germany, France) could therefore follow a restrictive budgetary course even in the face of weak overall activity, in order to respect the deficit ceilings imposed by the Stability Pact. This would undermine further the prospects for recovery. The Stability and Growth Pact is constraining the room for counter-cyclical manoeuvre, since the cyclical slowdown occurred before all EU member states had gained a sufficient "safety margin" from the 3 percent deficit ceiling.

Germany remains the laggard in the EU growth trail. The main causes lie in the heavy financial burden related to unification, a severe slump in the construction sector and a backlog in structural reform. The improvement in business sentiment in the first half of the year proved short-lived; since last summer, the IFO index has resumed a downward trend. The German economy is projected to grow by only ½ percent this year and by 1½ to 2 percent in 2003.

Developments in Central and Eastern Europe have been uneven. In Poland and the Czech Republic activity is being held back by real currency appreciation, while in Hungary it is upward bound. Growth for the region as a whole may attain 1½ percent in 2002, accelerating to 2½ to 3 percent in 2003.

Price pressure is set to further abate in the EU. Headline inflation may stabilise around a rate of 2 percent. The existing slack in capital and labour capacity utilisation, together with the relatively strong euro, are making for a slower inflationary momentum. However, political factors constitute a non-negligible risk: a war against Iraq could take oil prices to new highs in the short term and may lead to a further slump on stock markets.

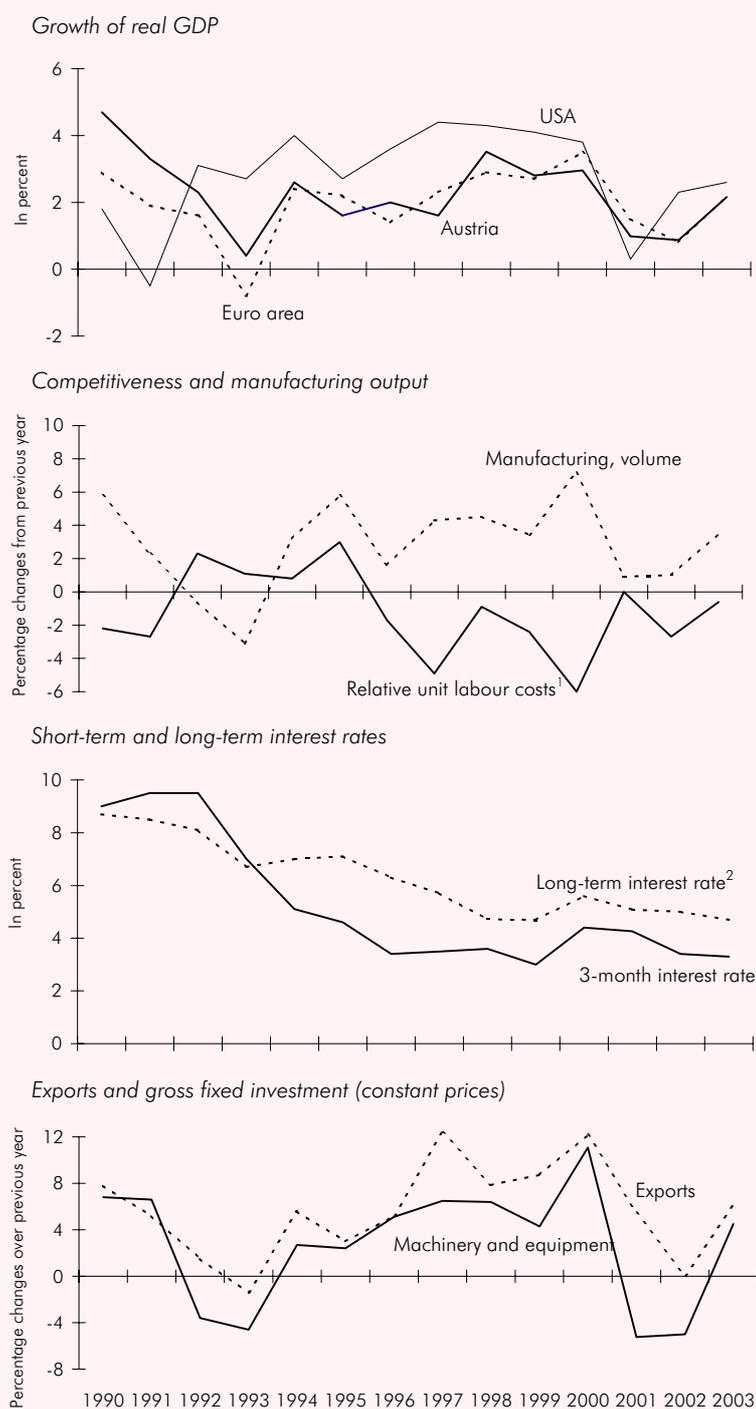
---

## Hesitant recovery of the European economy

---

## Long-term interest rates declining

Figure 1: International context



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

The projections are based on the technical assumption of broadly stable oil prices and the euro moving towards parity to the dollar next year. Further it has been assumed that the Federal Reserve will tighten the monetary reins as the recovery continues into 2003. The ECB would probably soon follow such a move. The rise in short-term interest rates will trigger a turnaround in long-term rates. Until then, the latter are set to decline further, largely on account of portfolio readjustments from equities towards bonds. Yields for 10-year Austrian government bonds, standing at 5 percent this year, will go down further on annual average 2003.

In the first half of 2002, activity in Austria developed as expected. Economic growth was 0.4 percent year-on-year, while on a seasonally adjusted basis real GDP increased by around ½ percent from quarter to quarter. Projected growth for the year as a whole must nevertheless be taken down by ¼ percentage point: international as well as domestic business surveys signal a stalling of the recovery in the third quarter instead of the earlier-expected acceleration.

Moreover, the flood disaster has probably led to shortfalls in production in the third quarter. In the surveys carried out mainly before that event, judgements on the current situation were hardly changed, but the high production expectations for the coming months were significantly reduced. The seasonally-adjusted gains in the second half of the year will probably turn out much lower than those recorded for the first semester. The annual rate of GDP growth of ¾ to 1 percent may thus remain even below the 2001 figure.

The projection for GDP growth slightly above 2 percent in 2003 is based on the assumption that the recovery will continue after the present "pause". Such a scenario is still subject to considerable risks, relating mainly to the international environment.

In the first half of the year, Austrian exports fared relatively well against the background of widespread cyclical weakness abroad. On annual average, volume exports of goods should gain 3 percent, exceeding foreign market growth by 1 percentage point. Overseas exports are rising markedly faster than those to the EU market. Among the external assumptions underlying the projections is an acceleration of exports to the EU area next year.

GDP growth in 2002 is supported by net exports, and in particular by weak imports. The fall in volume imports of goods by 3 percent year-on-year mainly reflects the low demand for investment goods this year. This leads to a substantial improvement in the trade and the current account balances. The current account deficit, projected at below 1 percent of GDP, is less than half the size of last year, with a further narrowing to be expected for 2003.

### GDP growth only accelerating in 2003

### Import slump reduces the current account deficit

Table 3: Productivity

	1998	1999	2000	2001	2002	2003
	Percentage changes from previous year					
<i>Total economy</i>						
Real GDP	+ 3.5	+ 2.8	+ 3.0	+ 1.0	+ 0.9	+ 2.2
Employment <sup>1</sup>	+ 0.7	+ 1.2	+ 0.5	+ 0.2	- 0.2	+ 0.6
Full-time equivalent	+ 0.8	+ 1.0	+ 1.3	+ 0.1	- 0.3	+ 0.5
Productivity (GDP per employment)	+ 2.8	+ 1.5	+ 2.5	+ 0.8	+ 1.1	+ 1.5
Full-time equivalent	+ 2.7	+ 1.8	+ 1.6	+ 0.9	+ 1.2	+ 1.6
<i>Manufacturing</i>						
Production <sup>2</sup>	+ 4.5	+ 3.4	+ 7.2	+ 0.9	+ 1.0	+ 3.5
Employees <sup>3</sup>	+ 0.1	- 0.7	+ 0.0	+ 0.2	- 2.3	- 0.5
Productivity per hour	+ 4.3	+ 4.8	+ 7.3	+ 1.3	+ 4.4	+ 3.9
Working hours per day per employee <sup>4</sup>	+ 0.1	- 0.6	- 0.1	- 0.6	- 1.0	+ 0.1

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

The tourism sector took a positive development in the first semester, with real value added of hotels and restaurants gaining 3.3 percent from last year. Growth will be smaller in the rest of the year, with the repercussions of cyclical weakness in Germany and of the floods being increasingly felt. The dampening cyclical impact will continue into 2003, such that output growth will remain moderate. The surplus in the tourism service balance should nevertheless post a small increase.

### Tourism to expand at a slower pace

Initially, the construction sector was more severely affected by the business cycle downturn than manufacturing. During 2002, however, the negative trend has come to a halt, notably in civil engineering. Demand is being stimulated by counter-cyclical government action as well as by reconstruction works following the flood disaster. The projection for

### Fall in construction activity petering out

construction output in 2002 is thus being revised from –2 to –1 percent. The demand-boosting factors will continue to operate in 2003. Moreover, the expected recovery should give fresh incentives to new construction of industrial structures. Total demand for construction is seen picking up by 1½ percent, still trailing overall GDP growth. The rise in the number of jobless construction workers should nevertheless be brought to a halt.

While investment behaviour is rather volatile over the cycle, private consumption exerts a stabilising influence. Having been flat year-on-year in the first half, consumption is projected to gain nearly 1 percent for the whole of 2002. Purchases of motor cars and spending on new homes by private households have fallen sharply, similar to corporate investment.

Gains in real disposable income generated by the cyclical recovery will make for stronger consumption growth of 1.8 percent in 2003. The increase should extend to durable consumer goods. The private household saving ratio has been biased by changes in tax regulations leading to advance payments of income tax, notably in 2001. In 2002 and 2003, the saving ratio is on a rising trend.

### Growth of private consumption almost unabated

Table 4: Private consumption, earnings and prices

	1998	1999	2000	2001	2002	2003
	Percentage changes from previous year, volume					
Private consumption expenditure	+ 2.8	+ 2.7	+ 2.5	+ 1.4	+ 1.0	+ 1.8
Durables	+ 5.8	+ 9.4	+ 3.9	– 2.6	– 2.0	+ 3.5
Non-durables and services	+ 2.3	+ 1.8	+ 2.3	+ 2.0	+ 1.4	+ 1.5
Household disposable income	+ 3.6	+ 2.2	+ 1.8	+ 0.2	+ 1.4	+ 2.0
Household saving ratio						
As a percentage of disposable income	8.0	7.7	6.7	5.5	6.0	6.6
	Percentage changes from previous year					
Direct lending to domestic non-banks <sup>1</sup>	+ 3.7	+ 5.2	+ 6.7	+ 3.5	+ 1.9	+ 2.4
	In percent					
Inflation rate						
National	0.9	0.6	2.3	2.7	1.8	1.4
Harmonised	0.8	0.5	2.0	2.3	1.8	1.4
Core inflation <sup>2</sup>	1.2	0.6	0.9	2.2	2.1	1.7

<sup>1</sup> End of period. – <sup>2</sup> Excluding unprocessed food (meat, fish, fruits, vegetables) and energy items.

The sharp fall in investment in machinery and vehicles which had set in last year, continued unabated in 2002, as had been foreshadowed by the regular WIFO investment survey. The projection for equipment investment is strongly corrected downwards, to a drop by 5 percent in 2002, comparable with the one recorded last year. The slump in investment and the swift rise in unemployment have prompted the Federal government to decide on a set of counter-cyclical measures. A special 10 percent investment premium expiring at the end of 2003 should provide incentives for carrying forward investment projects. Allowing for such effects, investment in machinery and equipment is projected to go up by 4 to 5 percent next year.

### Sharp fall in investment

Consumer prices are set to increase by 1.8 percent on annual average 2002, down by almost 1 percentage point from 2001 due to the deceleration of energy prices. The introduction of euro cash money has not fuelled overall inflation in the first instance. Since last summer, however, there have been more frequent signs that the changeover has been taken as an opportunity for hefty price increases for a number of services. Higher prices for tobacco and for services were the main reason for headline inflation bouncing back to 1.9 percent in August, after it had declined in the previous months.

Next year, inflation should moderate to a rate of 1.4 percent. In view of the cyclical weakness and low overall price pressure, the autumn 2002 wage round in the private sector is likely to lead to lower settlements than last year. The rise in the euro exchange rate should also dampen price increases, and prices for seasonal goods should revert to normal levels. Core inflation is expected to remain some ¼ percentage point above

### Inflation decelerating in 2003

headline inflation. Crude oil prices are a factor of uncertainty: a war in Iraq may first give rise to a price jump, followed by a steep fall once the war is over.

Wages per employee may rise by a similar 2¼ percent as in the current year. Private sector earnings are expected to go up distinctly less than in 2002, those in the public sector considerably more. The expected cyclical upturn will affect wages only as from the 2003 autumn round of negotiations.

Table 5: Earnings and international competitiveness

	1998	1999	2000	2001	2002	2003
	Percentage changes from previous year					
Gross earnings per employee <sup>1</sup>	+ 3.0	+ 2.0	+ 2.5	+ 3.1	+ 2.2	+ 2.2
Full-time equivalent	+ 3.2	+ 2.4	+ 2.3	+ 3.4	+ 2.4	+ 2.6
Gross real earnings per employee <sup>1</sup>	+ 2.5	+ 1.2	+ 1.0	+ 0.8	+ 0.4	+ 0.8
Net real earnings per employee	+ 2.3	+ 4.3	+ 1.7	+ 0.1	- 0.3	+ 0.2
Net wages and salaries	+ 3.3	+ 3.7	+ 4.3	+ 2.6	+ 2.0	+ 2.4
<i>Total economy</i>						
Unit labour costs	- 0.2	+ 0.4	- 0.1	+ 2.3	+ 1.2	+ 0.7
<i>Manufacturing</i>						
Unit labour costs	- 1.7	- 1.5	- 5.1	+ 2.1	- 1.3	- 0.6
Relative unit labour costs <sup>2</sup>						
Vis-à-vis trading partners	- 0.9	- 2.4	- 6.0	± 0.0	- 2.7	- 0.6
Vis-à-vis Germany	+ 0.4	- 1.1	- 2.4	± 0.0	- 3.6	- 1.2
Effective exchange rate – manufactures						
Nominal	+ 2.5	+ 0.6	- 2.7	+ 0.9	+ 0.4	+ 0.6
Real	+ 0.5	- 1.3	- 3.5	+ 0.3	± 0.0	± 0.0

<sup>1</sup> Employees according to National Accounts definition. – <sup>2</sup> Manufacturing, in a common currency; minus sign indicates improvement of competitiveness.

With the cyclical weakness, the labour market has deteriorated rapidly. In the first eight months of 2002, the number of actively employed fell by 11,000 from a year ago. The official employment statistics, which also include women out of work receiving child care benefits and which suggest a rise to new record levels every month, give an overly optimistic picture in this regard. Due to the new support granted to families, the number of women receiving such benefits is rising by 40,000 within two years. The increase in part-time work for the elderly ("Altersteilzeit") to a number of 14,000 of late, introduces a further positive bias into an otherwise critical development.

On annual average 2002, the cyclical weakness entails a net loss of 13,000 jobs, corresponding to a decline by 0.4 percent. Most affected are the manufacturing and the construction sectors, which also account for most of the rise in unemployment. Job cuts in the transport sector (postal and telecom services, Austrian railways) are mainly accommodated by early retirement.

The rate of unemployment (according to Eurostat) is moving up from 3.6 to 4.1 percent this year. More relevant for the government budget is, however, the jobless figure from the labour market service, which is set to rise by 31,000 to a level of 235,000 in 2002, corresponding to a rate of 6.9 percent of the dependent labour force. This definition of unemployment also includes people not "actively seeking work" (in particular seasonal workers) but still receiving unemployment benefits.

In 2003, the job losses of the current year should be offset. The expected gradual cyclical recovery is expected to lead to a net gain of 13,000 new jobs. Such gains are limited, since the early stages of the upturn give rise to a rebound in productivity in the first place. Unemployment is likely to remain flat at the relatively high current level.

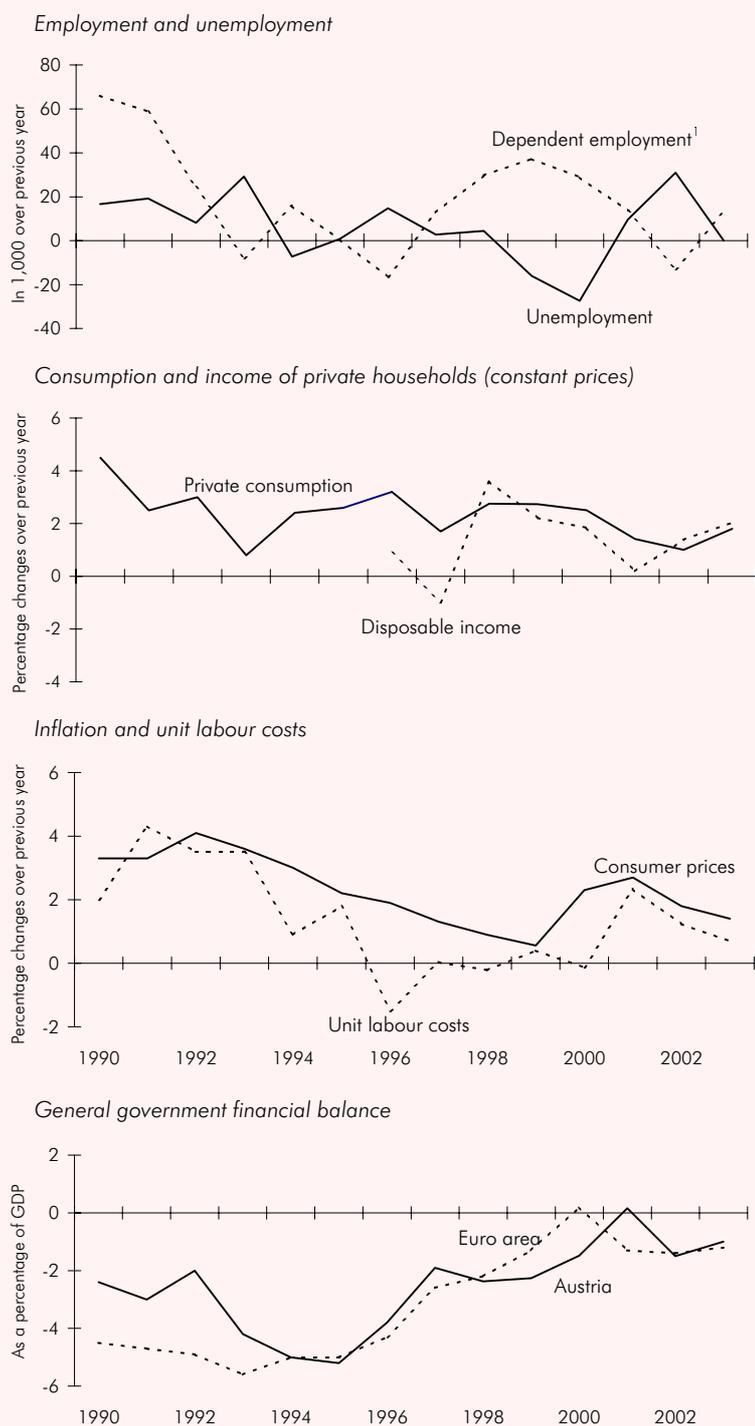
The National Action Plan (NAP) for employment targeted a decline in the unemployment rate (Eurostat definition) to 3.5 percent by 2002. This ambitious target has been missed because of the business cycle downturn. The European Commission criticises the Austrian authorities for not having taken additional labour market measures. The Federal government has now reacted to the weakening labour market by deciding in September on a set of counter-cyclical measures. The 10 percent premium for equipment and construction investment, limited to end-2003, the prolongation of measures in the context of

### Unemployment rising to nearly 7 percent in 2002, levelling off in 2003

*The cyclical downturn has led to a particularly strong rise in unemployment. The stimulating measures taken by the Federal government are intended to stem a further increase.*

the "youth safety net", an employment premium for apprentices and other measures are intended to stabilise overall activity and employment.

Figure 2: Economic performance



<sup>1</sup> Excluding parental leave and military service.

Table 6: Labour market

	1998	1999	2000	2001	2002	2003
	Changes from previous year (in 1,000)					
<i>Demand for labour</i>						
Civilian employment	+ 22.1	+ 32.2	+ 27.7	+ 15.9	+ 9.1	+ 33.9
Excluding parental leave and military service	+ 30.8	+ 38.2	+ 30.8	+ 15.1	- 11.9	+ 14.9
Dependent employment <sup>1</sup>	+ 21.1	+ 31.2	+ 25.8	+ 14.4	+ 8.0	+ 32.0
Excluding parental leave and military service	+ 29.8	+ 37.2	+ 28.9	+ 13.6	- 13.0	+ 13.0
Percentage changes from previous year	+ 1.0	+ 1.2	+ 1.0	+ 0.4	- 0.4	+ 0.4
Parental leave and military service <sup>1</sup>	- 8.7	- 6.0	- 3.1	+ 0.8	+ 21.0	+ 19.0
Foreign workers	- 0.2	+ 7.8	+ 13.4	+ 9.5	+ 4.0	+ 9.5
Self-employed <sup>2</sup>	+ 1.0	+ 1.0	+ 1.9	+ 1.5	+ 1.1	+ 1.9
<i>Labour supply</i>						
Economically active population						
aged 15 to 64	+ 11.0	+ 19.8	+ 25.2	+ 28.1	+ 22.9	+ 19.1
aged 15 to 59	+ 10.9	- 2.6	- 17.5	- 14.2	- 5.5	+ 3.1
Total labour force	+ 26.5	+ 16.2	+ 0.3	+ 25.5	+ 40.1	+ 33.9
Excluding parental leave and military service	+ 35.2	+ 22.2	+ 3.4	+ 24.7	+ 19.1	+ 14.9
Foreign	+ 0.7	+ 6.6	+ 12.0	+ 14.3	+ 10.0	+ 10.0
Migration of nationals	+ 3.9	+ 3.0	+ 1.0	- 1.0	± 0.0	- 0.5
Indigenous	+ 21.9	+ 6.6	- 12.7	+ 12.2	+ 30.1	+ 24.4
Excluding parental leave and military service	+ 30.6	+ 12.6	- 9.6	+ 11.4	+ 9.1	+ 5.4
<i>Surplus of labour</i>						
Registered unemployed <sup>3</sup>	+ 4.4	- 16.1	- 27.4	+ 9.6	+ 31.0	± 0.0
In 1,000	237.8	221.7	194.3	203.9	234.9	234.9
	In percent					
Unemployment rate						
Percent of total labour force <sup>4</sup>	4.5	3.9	3.7	3.6	4.1	4.1
Percent of total labour force <sup>3</sup>	6.5	6.0	5.3	5.5	6.2	6.2
Percent of dependent labour force <sup>3</sup>	7.2	6.7	5.8	6.1	6.9	6.9
Participation rate <sup>5</sup>	67.6	67.6	67.3	67.5	67.9	68.3
Excluding parental leave and military service <sup>6</sup>	70.7	71.2	71.5	72.2	72.7	72.9
Employment rate <sup>7</sup>	63.2	63.6	63.8	63.8	63.7	64.1
Excluding parental leave and military service <sup>6</sup>	66.1	66.9	67.7	68.2	68.0	68.3

<sup>1</sup> According to Federation of Austrian Social Security Institutions. – <sup>2</sup> According to WIFO. – <sup>3</sup> According to Labour Market Service. – <sup>4</sup> According to Eurostat. – <sup>5</sup> Total labour force as a percentage of economically active population (aged 15 to 64). – <sup>6</sup> As a percentage of population aged 15 to 59. – <sup>7</sup> Employment as a percentage of economically active population (aged 15 to 64).

Table 7: Key policy indicators

	1998	1999	2000	2001	2002	2003
<i>Fiscal policy</i>						
	As a percentage of GDP					
General government financial balance						
According to Maastricht definition	- 2.4	- 2.3	- 1.5	+ 0.2	- 1.5	- 1.0
According to National accounts	- 2.5	- 2.4	- 1.7	+ 0.0	- 1.7	- 1.2
General government primary balance	+ 1.4	+ 1.4	+ 2.3	+ 3.9	+ 1.9	+ 2.3
<i>Monetary policy</i>						
	In percent					
3-month interest rate	3.6	3.0	4.4	4.3	3.4	3.3
Long-term interest rate <sup>1</sup>	4.7	4.7	5.6	5.1	5.0	4.7
	Percentage changes from previous year					
<i>Effective exchange rate</i>						
Nominal	+ 2.8	+ 1.5	- 2.5	+ 1.0	+ 0.4	+ 0.9
Real	+ 0.3	- 1.1	- 3.6	+ 0.1	- 0.2	± 0.0

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

The general government budget will register a deficit of around 1½ percent of GDP this year, deviating from the targeted "zero deficit". The reasons for the slippage are the extended cyclical weakness and the flood-related fiscal burden. The cyclical weakness is giving rise to shortfalls in tax revenues and social security contributions as well as to higher transfers to the unemployed. Compensation of flood damages is putting further strain on government budgets. Excluding flood aid and unemployment benefits, government spending is broadly on target. In view of the deficit in prospect, the Minister of Finance has submitted a proposal for a supplementary budget totalling € 1.7 billion. The national stability pact with the Federal states and the municipalities has been suspended in the face of the flood damages. The overall flood-induced budgetary burden, including additional spending and revenues foregone, may amount to almost 1 percent of GDP, spread between 2002 and 2003.

For 2003, a general government deficit of slightly above 1 percent of GDP should be expected. This projection is rather tentative, as a Federal budget draft for 2003 has not yet been submitted and both wage settlements for the public sector and the adjustment rate for pensions are as yet unknown. Possible one-off measures (e.g., special dividends) are difficult to anticipate. It is further unclear whether a tax reform will take effect in 2003 (the projections are based upon the assumption of an unchanged tax system). Finally, in the present fragile cyclical situation, the growth prospects upon which revenue estimates are based, are more uncertain than usual. The Federal "package" of counter-cyclical measures is estimated to put an additional burden of around € 600 million on the 2003 general government budget.

### **Cyclical weakness and flood disaster putting strain on government finances**

*As a consequence of the cyclical downturn and the budgetary implications of the flood disaster, the general government deficit will attain 1½ percent of GDP in 2002.*