

Christian Glocker

# Business Cycle Upswing in Austria

## Economic Outlook for 2017 and 2018

### Business Cycle Upswing in Austria. Economic Outlook for 2017 and 2018

From a rate of growth of 1.5 percent in 2016, demand and output in Austria are expected to accelerate significantly in 2017 and 2018. Leading indicators clearly suggest a further strengthening of business activity. Apart from lively internal demand benefitting from benign labour market conditions, foreign trade will rebound and contribute more strongly to GDP growth than in recent months. In this environment, the Austrian economy is expected to expand by 2.0 percent in the current year and 1.8 percent in 2018.

**Contact:**

**Christian Glocker:** WIFO, 1030 Vienna, Arsenal, Objekt 20, [christian.glocker@wifo.ac.at](mailto:christian.glocker@wifo.ac.at)

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**Data processing:** Astrid Czaloun ([astrid.czaloun@wifo.ac.at](mailto:astrid.czaloun@wifo.ac.at)), Maria Riegler ([maria.riegler@wifo.ac.at](mailto:maria.riegler@wifo.ac.at))

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Austria's economy is enjoying a period of cyclical upswing. Support comes from domestic demand, driven by favourable labour market developments. Exports pick up in step with strengthening aggregate demand on foreign markets. Growth of the US economy is set to edge up notably in 2017, while activity in the euro area should stay on a firm upward path. With prices for raw materials rising on world markets, growth in commodity-exporting countries should regain momentum. Hence, exports should provide a distinctly stronger contribution to Austria's GDP growth than in recent periods, thereby supporting the healthy pace of domestic demand forces.

In this environment of a broad-based upward trend across demand components on the one hand and production across sectors on the other, business activity in Austria is bound to gather momentum. The favourable signs from forward-looking indicators also confirm the prospect of a sustained cyclical upturn over the entire forecast horizon. In the event, real GDP will gain 2.0 percent in the current year and 1.8 percent in 2018, exceeding in both years the rate of potential output growth. While overall productive capacity will likely be extended with the increase in demand and output, the output gap will still be negative by the end of 2018. The implicit dampening impact on inflation should nevertheless ebb and upward pressure on prices may gradually mount. After an annual increase of 0.9 percent in 2016, the Consumer Price Index (CPI) is projected to climb by 1.7 percent each in 2017 and 2018. Oil price volatility remains a risk, notably for the inflation outlook, which is nevertheless deemed balanced, much as the risks to the overall growth forecast.

Public finances stand to benefit from lively economic activity and lower debt service cost, but the improvement in the fiscal balance is held back by a moderately expansionary policy stance. As the latter will gradually abate, 2017 and 2018 should see steady progress in deficit reduction. While the cyclical upswing will stimulate

employment growth, the sustained expansion of labour supply will allow the jobless rate to fall only slightly this year and no further in 2018.

Table 1: Main results

	2013	2014	2015	2016	2017	2018	
	Percentage changes from previous year						
Gross domestic product, volume	+ 0.1	+ 0.6	+ 1.0	+ 1.5	+ 2.0	+ 1.8	
Manufacturing	+ 0.3	+ 1.6	+ 1.8	+ 1.7	+ 3.6	+ 2.9	
Wholesale and retail trade	- 2.1	+ 2.0	+ 0.6	+ 2.1	+ 2.5	+ 2.0	
Private consumption expenditure <sup>1</sup> , volume	- 0.1	- 0.3	- 0.0	+ 1.5	+ 1.3	+ 1.2	
Consumer durables	- 3.0	+ 0.1	- 0.6	+ 3.1	+ 2.5	+ 1.0	
Gross fixed capital formation, volume	+ 2.2	- 0.9	+ 0.7	+ 2.9	+ 2.6	+ 2.4	
Machinery and equipment <sup>2</sup>	+ 2.4	- 1.0	+ 3.6	+ 6.4	+ 4.0	+ 2.5	
Construction	- 0.9	- 0.1	- 1.2	+ 1.3	+ 1.6	+ 1.4	
Exports, volume	+ 0.5	+ 2.3	+ 3.6	+ 1.7	+ 3.6	+ 3.4	
Exports of goods	- 0.7	+ 2.2	+ 3.5	+ 1.5	+ 3.7	+ 3.6	
Imports, volume	+ 0.7	+ 1.3	+ 3.4	+ 2.8	+ 3.3	+ 3.0	
Imports of goods	- 2.0	+ 0.8	+ 4.2	+ 3.2	+ 3.3	+ 3.1	
Gross domestic product, value	+ 1.7	+ 2.4	+ 2.9	+ 2.8	+ 3.3	+ 3.3	
	billion €	322.54	330.42	339.90	349.49	361.18	372.95
Current account balance as a percentage of GDP	2.0	2.4	1.8	1.6	1.6	1.6	
Consumer prices	+ 2.0	+ 1.7	+ 0.9	+ 0.9	+ 1.7	+ 1.7	
Three-month interest rate	percent	0.2	0.2	- 0.0	- 0.3	- 0.3	- 0.1
Long-term interest rate <sup>3</sup>	percent	2.0	1.5	0.7	0.4	0.6	0.9
General government financial balance according to Maastricht definition							
As a percentage of GDP		- 1.4	- 2.7	- 1.0	- 1.4	- 1.2	- 0.7
Persons in active dependent employment <sup>4</sup>		+ 0.6	+ 0.7	+ 1.0	+ 1.6	+ 1.6	+ 1.3
Unemployment rate							
Eurostat definition <sup>5</sup>		5.4	5.6	5.7	6.0	5.9	5.9
National definition <sup>6</sup>		7.6	8.4	9.1	9.1	8.9	8.9

Source: WIFO. 2017 and 2018: forecast. – <sup>1</sup> Including non-profit institutions serving households. – <sup>2</sup> Including weapons systems. – <sup>3</sup> 10-year central government bonds (benchmark). – <sup>4</sup> Excluding persons with valid employment contract receiving child care benefit or being in military service. – <sup>5</sup> As a percentage of total labour force, Labour Force Survey. – <sup>6</sup> As a percentage of dependent labour force, unemployed persons according to Public Employment Service Austria.

## 1. The starting situation

In 2016, the Austrian economy grew by 1.5 percent, significantly more strongly than in the years before. Demand and output steadily gained momentum during the year, maintaining the positive trend from 2015. Adjusted for the usual fluctuations of quarterly data, the acceleration of activity can be observed since the end of 2014: in that year, average growth of quarterly GDP was 0.1 percent, picking up to 0.3 percent in 2015 and 0.4 percent in 2016, the highest rate since 2011.

Moreover, GDP growth in 2016 was sustained by a broader base across the demand components, with both private consumption and investment gaining strength. Domestic demand was thus the main driver of activity. The external contribution to GDP growth was negative however, as lively import growth was accompanied by weaker exports.

On the supply side, the broader base of the upswing is reflected by a significant acceleration in cyclically-sensitive production sectors. This goes for manufacturing and related trade and other business activities, and for the financial sector which after an extended period of restructuring swung to a positive contribution to GDP growth.

In line with buoyant activity, conditions brightened also on the domestic labour market. Job creation gathered further pace in 2016 and allowed unemployment to decline. Although the jobless rate rose once again in 2016 from the previous year, the seasonally-adjusted monthly figures started heading down. Against this background, also the output gap narrowed further, accompanied however by a slackening in the inherent inflation-dampening effect. Still, the latest increase in the inflation rate has been primarily driven by rising world market prices for raw materials.

*The Austrian economy has lately received increasing stimulus from internal demand. GDP growth has been driven by higher private consumption, together with firms' greater appetite for investment. The growth contribution of net exports, on the other hand, was negative.*

## 2. The framework conditions

The present projections take on board information available until mid-March 2017 on global economic developments, commodity prices, exchange and interest rates. The forecast horizon stretches from the first quarter 2017 to the fourth quarter 2018. As for policy settings, we include all measures already adopted or sufficiently specified and deemed likely to be implemented. Measures proposed in the new edition of the work programme of the Austrian federal government presented in early 2017 have not been included into the forecast.

### 2.1 Global economic activity staying robust

In 2016, world economic output increased by 3.1 percent, largely in line with expectations. In the second half of the year, business activity strengthened noticeably, as witnessed by the gains in industrial production and merchandise trade (as recorded by the Dutch Centraal Planbureau). The favourable picture conveyed by leading indicators points towards continued expansion in the early months of 2017. Thus, the global Purchasing Managers' Index for the manufacturing sector compiled by Markit rose once again in February from its already high level.

Table 2: International economy

	Percentage shares 2015		2013	2014	2015	2016	2017	2018
	Austria's exports of goods	World GDP <sup>1</sup>						
	GDP volume, percentage changes from previous year							
EU	69.1	16.9	+ 0.2	+ 1.6	+ 2.2	+ 1.9	+ 2.0	+ 1.8
UK	3.2	2.4	+ 1.9	+ 3.1	+ 2.2	+ 2.0	+ 2.0	+ 1.5
Euro area	51.1	12.0	- 0.3	+ 1.2	+ 2.0	+ 1.7	+ 1.9	+ 1.7
Italy	6.3	1.9	- 1.7	+ 0.1	+ 0.7	+ 1.0	+ 1.0	+ 1.4
France	4.5	2.3	+ 0.6	+ 0.6	+ 1.3	+ 1.2	+ 1.6	+ 1.6
CEEC <sup>5,2</sup>	14.1	1.6	+ 1.4	+ 3.2	+ 3.9	+ 2.6	+ 3.2	+ 3.1
Czech Republic	3.6	0.3	- 0.5	+ 2.7	+ 4.5	+ 2.3	+ 2.1	+ 2.6
Hungary	3.3	0.2	+ 2.1	+ 4.0	+ 3.1	+ 2.0	+ 2.6	+ 2.5
Poland	3.2	0.9	+ 1.4	+ 3.3	+ 3.9	+ 2.8	+ 3.9	+ 3.5
USA	6.9	15.8	+ 1.7	+ 2.4	+ 2.6	+ 1.6	+ 2.2	+ 2.1
Switzerland	5.8	0.4	+ 1.8	+ 2.0	+ 0.8	+ 1.4	+ 1.5	+ 1.9
China	2.5	17.3	+ 7.8	+ 7.3	+ 6.9	+ 6.7	+ 6.3	+ 6.2
Total <sup>3</sup>								
PPP-weighted <sup>4</sup>		50.4	+ 3.3	+ 3.8	+ 3.9	+ 3.5	+ 3.5	+ 3.4
Export weighted <sup>5</sup>	84.3		+ 0.7	+ 1.9	+ 2.3	+ 2.0	+ 2.1	+ 2.0
Market growth <sup>6</sup>			+ 1.7	+ 3.6	+ 3.0	+ 2.9	+ 3.6	+ 3.5
<i>Forecast assumptions</i>								
Crude oil prices								
Brent, \$ per barrel			108.7	99.0	52.5	43.7	57	59
Exchange rate								
\$ per €			1.328	1.329	1.110	1.107	1.05	1.05
Key interest rate								
ECB main refinancing rate <sup>7</sup> , percent			0.6	0.2	0.1	0.0	0.0	0.3
10-year government bonds yields Germany, percent			1.6	1.2	0.5	0.1	0.2	0.8

Source: WIFO. 2017 and 2018: forecast. – <sup>1</sup> PPP-weighted. – <sup>2</sup> Czech Republic, Hungary, Poland, Slovenia, Slovakia. – <sup>3</sup> EU, USA, Switzerland, China. – <sup>4</sup> Weighted by GDP at purchasing power parities in 2015. – <sup>5</sup> Weighted by shares of Austrian goods exports in 2015. – <sup>6</sup> Real import growth of trading partners, weighted by shares of Austrian goods exports. – <sup>7</sup> Minimum bid rate.

Economic activity accelerated in most of the industrialised countries during the last six months of 2016. Part of it may have been a positive fallout from the revival in emerging market countries. Indeed, healthy internal demand sustained GDP growth in China which proved highly robust throughout 2016 and looks set to extend into spring 2017, as suggested by early indicators. After a slump of nearly 3 percent in 2015, real GDP in Russia may have bottomed out in 2016, according to first official estimates. While no quarterly data are yet available, several indicators point to a rebound in the second half of last year. Many sentiment indicators also improved, in particular consumer confidence. Leading indicators delivered a brighter picture also

for Brazil, even if the severe recession of the previous years may not have definitely ended by the second half of 2016. However, the adverse trend should turn around during the first three months of 2017 and spill over to other countries in Latin America, strengthening the forces of growth in the entire region. In the commodity-exporting emerging market countries, the expected increase in world market prices for raw materials should provide positive incentives.

After a "soft patch" in 2016, the US economy will post stronger growth in 2017, and also in the EU business activity should revive. Overall, GDP growth in the EU was remarkably stable in 2016, thereby prolonging the positive trend of 2015. Nevertheless, developments differed markedly across member countries. While growth remained stable at a high level in Spain and strengthened in the UK, activity slackened significantly towards the end of 2016 in Finland and once more in Greece. Leading indicators are pointing up for most countries and have lately improved further.

Against this background, WIFO projects for 2017 and 2018 an annual growth of approximately 2 percent for Austria's key export markets. Some countries should see an acceleration of demand and output growth in 2017, such as the USA, the UK, the emerging markets in Latin America and many countries in East-central and Eastern Europe (e.g., Poland, Hungary and Russia). Significantly higher annual growth rates for 2017 in these countries are partly the result of a high positive statistical carry-over from 2016. The rebound of demand and output in the euro area in 2017 may exceed earlier expectations, boding well for Austria's export prospects. Growth in the four major euro-area economies will remain robust or gather pace, largely fuelled by buoyant domestic demand. Results from the latest bank lending survey for the euro area show a relaxation of credit standards, which should stimulate private consumption and encourage business investment. Likewise, a further easing of the fiscal stance in many countries will provide positive growth incentives. Overall, real GDP for the euro area is projected at 1.9 percent for 2017 and 1.7 percent for 2018.

Oil prices hit a low in early 2016 and have been trending upwards since. The readjustment of oil production by OPEC last year and the accompanying supply reduction may have been a factor. Nevertheless, the oil market still remains in the unusual situation of contango<sup>1</sup>, resulting from substantial excess supply and high levels of oil inventories. WIFO's current oil price assumption remains close to the one of last December. With the euro expected to depreciate against the dollar, oil prices should however rise somewhat more on a euro basis in 2017. World market quotations for other raw materials also rebounded in the course of 2016. If, as anticipated, global activity remains firm and the supply overhang on various commodity markets gradually narrows, raw material prices should remain under upward pressure over the forecast period.

## 2.2 Economic policy keeping an expansionary stance

The ECB has continued its expanded asset purchase programme. Although the ECB Council decided last December to reduce bond purchases from 80 billion € to 60 billion € per month as from April 2017, the monetary policy stance remains expansionary. On present perspectives, this setting will be maintained until euro area inflation comes close to the medium-term target rate of 2 percent per year. The strategy has helped to keep interest rates on government bonds at a very low level. Yet, forward-looking market expectations are upward bound, and so are interest rates on bank loans in Austria. In line with the low credit rates, lending standards have been further relaxed. As witnessed by the latest results of the bank lending survey, only 14 percent of the companies applying for bank credit had to accept cuts on the amount or the conditions from their original request. This is the lowest figure since the introduction of the survey as part of the regular WIFO Business Cycle Survey, indicating a further easing of credit supply conditions.

*The ECB is likely to maintain its expansionary monetary policy throughout 2017. First interest rate hikes should be expected for 2018.*

<sup>1</sup> Contango is a situation where the futures price of a commodity is above the expected future spot price. A market that is in contango indicates that the forward or futures curve is upward sloping.

Table 3: Fiscal and monetary policy – key figures

	2013	2014	2015	2016	2017	2018
	As a percentage of GDP					
<i>Fiscal policy</i>						
General government financial balance <sup>1</sup>	- 1.4	- 2.7	- 1.0	- 1.4	- 1.2	- 0.7
General government primary balance	1.2	- 0.3	1.3	0.8	0.7	1.0
General government total revenue	49.9	50.0	50.6	49.6	49.5	49.4
General government total expenditure	51.2	52.8	51.6	51.0	50.7	50.2
	Percent					
<i>Monetary policy</i>						
Three-month interest rate	0.2	0.2	- 0.0	- 0.3	- 0.3	- 0.1
Long-term interest rate <sup>2</sup>	2.0	1.5	0.7	0.4	0.6	0.9

Source: WIFO. 2017 and 2018: forecast. – <sup>1</sup> According to Maastricht definition. – <sup>2</sup> 10-year central government bonds (benchmark).

The credit-to-GDP gap in Austria is broadly stable, while remaining in negative territory<sup>2</sup>. Against this background, the Austrian Financial Market Stability Board decided in March to keep refraining from the activation of the counter-cyclical capital buffer, maintaining its level at 0 percent of the risk-weighted assets. Going forward however, macro-prudential policy is likely to be tightened moderately over the forecast period. This course is essentially determined by the road map for the implementation of Basle III; yet, given the sustained flood of liquidity from the ECB, credit supply is unlikely to be significantly restrained in 2017.

The present macroeconomic forecast includes only those fiscal policy measures that have either already been adopted or sufficiently specified. On present assumptions, the general government budget will remain in deficit over the entire projection period. While public finances profit from benign cyclical developments and low debt service cost, the fiscal stance exhibits an expansionary bias. Since the latter is set to diminish over the forecast horizon, the negative balance should narrow.

Despite strong revenue growth from cyclically-sensitive taxes, the revenue-to-GDP ratio is expected to edge down. Reasons are inter alia the cut in the contribution rate for the Family Benefit Fund and the reform of the stability fee for banks. Also the government expenditure-to-GDP ratio is likely to head down. The main factors here are lower discretionary spending (reduced asset transfers to ailing banks in 2018), relief in unemployment subsidies and moderation in public consumption growth. Moreover, debt service cost is set to decline further thanks to the persistent low-interest environment. Major budgetary risks may arise in particular from new measures planned by the government (see chapter 4).

*Macro-prudential policy in Austria is geared towards stimulating credit growth.*

*Domestic fiscal policy remains moderately expansionary in 2017, notwithstanding the favourable business outlook.*

### 3. Growth outlook for Austria brightens markedly

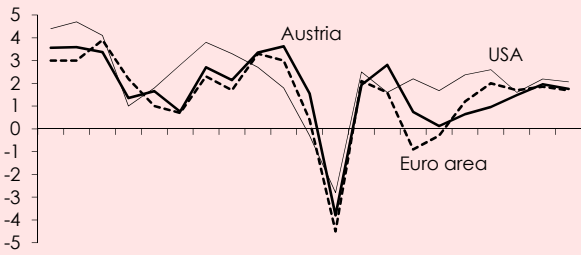
Last February, the results of the regular WIFO Business Cycle Survey showed a further improvement of the already upbeat judgements of Austrian companies. The partial index for current conditions in the construction sector rose to 22.8 points, reflecting a highly optimistic sentiment. The high level of confidence was also confirmed for manufacturing and services. Firms' forward-looking assessment rebounded from the temporary setback of the previous month, as the index climbed to its highest mark since March 2011. Judgements differed somewhat between sectors: the expectations index for construction remained flat, but at +7.2 points comfortably in positive territory. The already highly optimistic expectations in manufacturing strengthened further, and confidence rose even more in the service sector where the index climbed to a high not seen since spring 2011.

*The Austrian economy is enjoying a period of cyclical upswing. Lively domestic demand has been the main driver of activity so far. On the supply side, the manufacturing sector has been the major beneficiary. The underlying cyclical trend for Austria remains upward bound, with leading indicators suggesting continued expansion in spring 2017.*

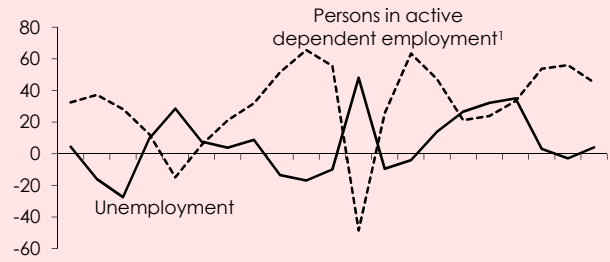
<sup>2</sup> The credit-to-GDP gap is defined as the difference between the credit-to-GDP ratio and its trend. A positive gap indicates that the current credit-to-GDP value is higher than its trend. According to the BCBS methodology this is a sign of excessive credit growth (<https://www.fmsg.at/en/publications/warnings-and-recommendations/2017/recommendation-for-the-countercyclical-capital-buffer.html>).

Figure 1: Indicators of economic performance

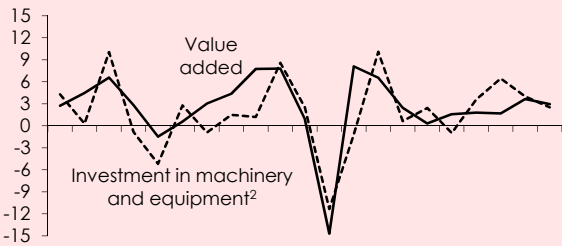
Growth of real GDP  
Percent



Employment and unemployment  
Change from previous year in 1,000



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



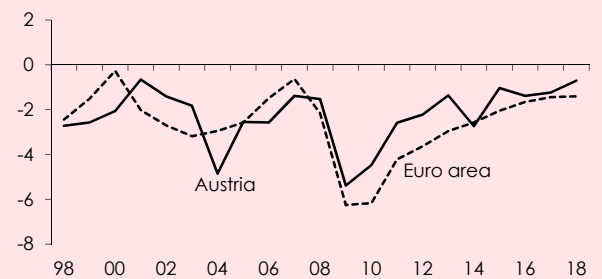
Inflation and unit labour costs  
Percentage changes from previous year



Trade (according to National Accounts)  
Percentage changes from previous year, volume



General government financial balance  
As a percentage of GDP



Source: WIFO. 2017 and 2018: forecast. – <sup>1</sup> Excluding persons with valid employment contract receiving child care benefit or being in military service, and unemployed persons in training; break in 2007-08 due to changes in the employment statistics. – <sup>2</sup> Including weapons systems. – <sup>3</sup> 10-year central government bonds (benchmark).

The business cycle indicator of Bank Austria has for several months followed an upward trend and has reached its highest level since summer 2011, signalling a robust growth of the domestic economy at the beginning of the year. The strong results for February have been shaped by optimism on the part of consumers as well as manufacturing industry.

The Purchasing Managers' Index compiled by Bank Austria, while levelling off at 57.2 points in February, keeps signalling highly favourable cyclical conditions. New

orders are rising on a broad front, from, in particular, intermediate goods to demand for investment and consumer goods.

Likewise, the WIFO Leading Indicator keeps rising, though lately somewhat less than in the two months before. The upward trend was generated by the domestic components, while among the foreign components those for the industrial sector slackened somewhat.

The leading indicators have thus reached a level comparable with earlier cyclical boom periods. Short-term growth prospects have again become brighter since the last forecast revision of December 2016. Current information suggests that GDP growth in 2017 will accelerate from last year.

### 3.1 GDP growth gathers pace

On present external conditions and policy settings, the adjusted annual rate of real GDP growth is projected to move from 1.4 percent in 2016 to 2.2 percent in 2017 and 1.8 percent in 2018 (Figure 2 and Table 4). The buoyant expansion in the current year is the result of a carry-over of +0.7 percentage points from last year and the strong momentum of growth in the course of the year, particularly in the first and second quarter 2017. Both benign factors should also be at work in 2018. The unadjusted rate of GDP growth of 2.0 percent for 2017 is somewhat lower, due to calendar effects (leap day in 2016; lower number of working days in 2017; Table 4).

*Austria's GDP growth gathered further momentum in the second half of 2016. Thanks to better framework conditions and in line with the positive messages from leading indicators, demand and output growth should strengthen over the forecast period.*

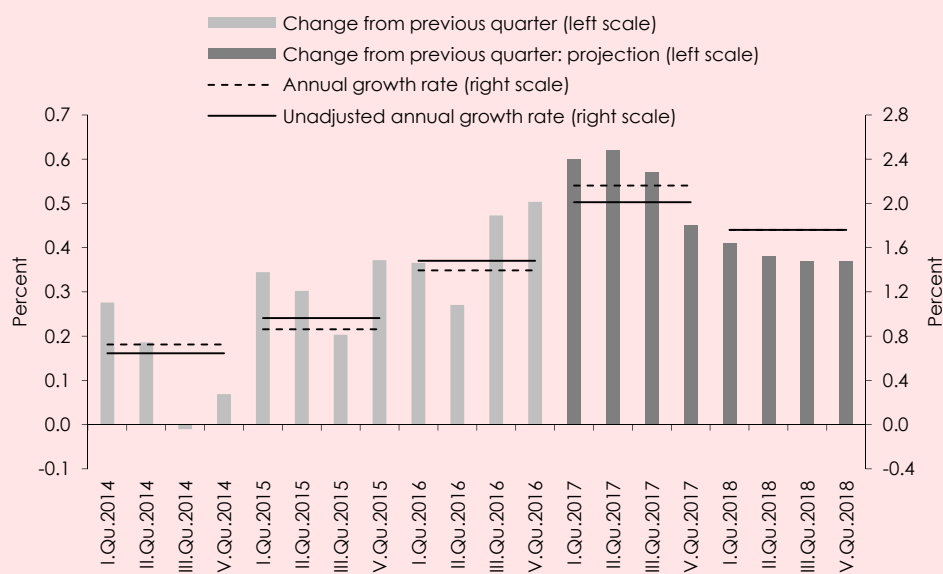
Table 4: Technical note to the projection of real GDP growth

		2015	2016	2017	2018
Growth carry-over <sup>1</sup>	percentage points	+ 0.1	+ 0.5	+ 0.7	+ 0.8
Growth rate during the year <sup>2</sup>	percent	+ 1.2	+ 1.6	+ 2.3	+ 1.5
<b>Annual growth rate</b>	<b>percent</b>	<b>+ 1.0</b>	<b>+ 1.5</b>	<b>+ 2.0</b>	<b>+ 1.8</b>
Adjusted annual growth rate <sup>3</sup>	percent	+ 0.9	+ 1.4	+ 2.2	+ 1.8
Calendar effect <sup>4</sup>	percentage points	+ 0.1	+ 0.1	- 0.2	± 0.0

Source: WIFO. 2017 and 2018: forecast. – <sup>1</sup> Impact of year-earlier growth dynamics on growth in the current year. Equals the annual growth rate in the current year, if the level of GDP in the current year remains constant from the fourth quarter of the previous year; trend-cycle component. – <sup>2</sup> Reflects the growth dynamics during a calendar year. Equals the year-on-year growth rate for the fourth quarter; trend-cycle component. – <sup>3</sup> Trend-cycle component. – <sup>4</sup> Impact of the annual number of working days and the leap day.

Figure 2: Cyclical profile Austria

GDP volume, trend-cycle component



Source: WIFO.

Demand and output growth thereby exceeds the expansion of Austria's productive potential. While the corporate sector will likely enhance productive capacity in response to the cyclical rebound in aggregate demand, the output gap will still not have closed at the forecast horizon. From the present perspective, production capacities will remain under-utilised.

Table 5: Gross value added

At basic prices

	2015	2016	2017	2018	2015	2016	2017	2018
	Billion € (reference year 2010)				Percentage changes from previous year			
<i>Volume (chain-linked series)</i>								
Agriculture, forestry and fishing	3.99	4.18	4.18	4.18	+ 0.4	+ 4.9	± 0.0	± 0.0
Manufacturing including mining and quarrying	56.65	57.69	59.79	61.55	+ 1.5	+ 1.8	+ 3.6	+ 2.9
Electricity, gas and water supply, waste management	8.15	7.81	7.95	8.07	+ 1.2	- 4.2	+ 1.8	+ 1.5
Construction	16.18	16.35	16.64	16.88	- 1.1	+ 1.0	+ 1.8	+ 1.4
Wholesale and retail trade	34.80	35.55	36.44	37.18	+ 0.6	+ 2.1	+ 2.5	+ 2.0
Transportation	15.02	14.95	15.15	15.41	+ 0.3	- 0.5	+ 1.4	+ 1.7
Accommodation and food service activities	13.20	13.51	13.77	13.93	+ 1.0	+ 2.3	+ 1.9	+ 1.2
Information and communication	9.53	9.58	9.80	9.99	+ 1.5	+ 0.5	+ 2.3	+ 2.0
Financial and insurance activities	11.49	11.86	11.83	12.07	+ 0.7	+ 3.2	- 0.2	+ 2.0
Real estate activities	26.49	27.02	27.56	28.18	+ 1.1	+ 2.0	+ 2.0	+ 2.2
Other business activities <sup>1</sup>	26.13	26.47	27.21	27.98	+ 0.9	+ 1.3	+ 2.8	+ 2.8
Public administration <sup>2</sup>	47.81	48.39	48.68	49.03	+ 0.8	+ 1.2	+ 0.6	+ 0.7
Other service activities <sup>3</sup>	7.62	7.67	7.72	7.77	- 0.5	+ 0.7	+ 0.6	+ 0.6
Total gross value added <sup>4</sup>	276.94	280.92	286.54	291.97	+ 0.8	+ 1.4	+ 2.0	+ 1.9
Gross domestic product at market prices	310.47	315.07	321.23	326.86	+ 1.0	+ 1.5	+ 2.0	+ 1.8

Source: WIFO. 2017 and 2018: forecast. – <sup>1</sup> Professional, scientific and technical activities; administrative and support service activities (NACE M and N). – <sup>2</sup> Including defence, compulsory social security, education, human health and social work activities (NACE O to Q). – <sup>3</sup> Arts, entertainment and recreation; other service activities; activities of households (NACE R to U). – <sup>4</sup> Before deduction of subsidies and attribution of taxes on products.

Table 6: Private consumption, income and prices

	2013	2014	2015	2016	2017	2018
	Percentage changes from previous year, volume					
Private consumption expenditure <sup>1</sup>	- 0.1	- 0.3	- 0.0	+ 1.5	+ 1.3	+ 1.2
Durable goods	- 3.0	+ 0.1	- 0.6	+ 3.1	+ 2.5	+ 1.0
Non-durable goods and services	+ 0.2	- 0.3	+ 0.1	+ 1.4	+ 1.2	+ 1.3
Household disposable income	- 1.9	- 0.1	+ 0.3	+ 2.7	+ 1.9	+ 1.6
As a percentage of disposable income						
Household saving ratio						
Including adjustment for the change in pension entitlements	7.0	7.0	7.3	8.5	9.0	9.3
Excluding adjustment for the change in pension entitlements	6.2	6.4	6.7	7.7	8.3	8.6
Percentage changes from previous year						
Direct lending to domestic non-banks (end of period)	- 1.2	+ 0.3	+ 2.0	+ 1.8	+ 1.7	+ 1.3
Percent						
Inflation rate						
National	2.0	1.7	0.9	0.9	1.7	1.7
Harmonised	2.1	1.5	0.8	1.0	1.8	1.7
Core inflation <sup>2</sup>	2.3	1.9	1.7	1.5	1.5	1.7

Source: WIFO. 2017 and 2018: forecast. – <sup>1</sup> Private households including non-profit institutions serving households. – <sup>2</sup> Excluding energy and unprocessed food (meat, fish, fruits, vegetables).



From the expenditure side of GDP, the upswing is largely shaped by lively internal demand, now – unlike in 2016 – receiving rising support from exports. On the production side, activity picked up already in 2016. The broad-based upturn across sectors and accelerating overall growth suggest that sectoral shocks will become more important for stimulating GDP growth. Over the forecast period this will be illustrated by the performance of manufacturing industry and its pro-cyclical effect on other sectors like transport, trade and other business activities. On the expenditure side, lively industrial activity is mirrored by a lasting increase in investment (mostly in machinery and equipment) which in turn has a pro-cyclical impact on employment and thus on private consumption. In such an environment of a broad-based pick-up of demand and output, the Austrian economy should stage a self-sustained cyclical upswing. The latter will also benefit from a benign labour market situation and higher private incomes. The positive picture conveyed by the leading indicators also bodes well for the cyclical boom to extend over the entire projection horizon. The recovery that got off the ground in the last years has thus turned into a genuine cyclical upswing.

### 3.2 Export growth supported by upswing in the euro area

Under the assumption underlying this forecast of a gradual expansion of world trade and a pick-up in global economic activity, Austrian exports should gain strength. WIFO's regular Business Cycle Survey shows for February a slight improvement of export orders received by manufacturers; firms turned again more optimistic than they were in the fourth quarter 2016. The balance of positive and negative responses has been rising since the middle of 2016 and by February comfortably exceeded the long-term average. Producers of investment goods and motor car components rated their foreign order levels much better than producers of consumer goods. At the same time, firms were more sceptical about their export prospects than one quarter earlier. The export indicator of Oesterreichische Nationalbank shows persistently high export volumes for spring 2017. After the decline in merchandise exports in the second half of 2016, the increase in foreign orders and companies' strong confidence suggest a forceful rebound of export growth.

Over the forecast horizon, exports stand to benefit from rising demand from partners in the euro area and the cyclical revival in the USA as well as in East-central Europe. Assuming constant market shares and no change in price competitiveness, volume export growth of goods and services is projected to accelerate from 1.7 percent in 2016 to 3.6 percent in 2017 and 3.4 percent in 2018.

Table 7: Expenditure on GDP

Volume (chain-linked series)

	2015	2016	2017	2018	2015	2016	2017	2018
	Billion € (Reference year 2010)				Percentage changes from previous year			
Final consumption expenditure	222.51	225.80	228.67	231.38	+ 0.6	+ 1.5	+ 1.3	+ 1.2
Households <sup>1</sup>	160.24	162.68	164.86	166.90	- 0.0	+ 1.5	+ 1.3	+ 1.2
General government	62.32	63.16	63.85	64.52	+ 2.1	+ 1.3	+ 1.1	+ 1.0
Gross capital formation	73.20	75.12	77.10	78.94	+ 0.5	+ 2.6	+ 2.6	+ 2.4
Gross fixed capital formation	70.37	72.44	74.34	76.10	+ 0.7	+ 2.9	+ 2.6	+ 2.4
Machinery and equipment <sup>2</sup>	24.39	25.96	27.00	27.67	+ 3.6	+ 6.4	+ 4.0	+ 2.5
Construction	31.70	32.12	32.63	33.10	- 1.2	+ 1.3	+ 1.6	+ 1.4
Other investment <sup>3</sup>	14.32	14.47	14.86	15.49	+ 0.6	+ 1.0	+ 2.7	+ 4.2
Domestic demand	297.21	303.16	308.46	313.04	+ 0.8	+ 2.0	+ 1.8	+ 1.5
Exports	172.38	175.35	181.58	187.72	+ 3.6	+ 1.7	+ 3.6	+ 3.4
Travel	13.24	13.52	13.81	13.98	+ 4.5	+ 2.1	+ 2.2	+ 1.2
Minus Imports	159.00	163.38	168.72	173.77	+ 3.4	+ 2.8	+ 3.3	+ 3.0
Travel	6.30	6.22	6.27	6.30	- 0.3	- 1.3	+ 0.8	+ 0.5
Gross domestic product	310.47	315.07	321.23	326.86	+ 1.0	+ 1.5	+ 2.0	+ 1.8
Value	339.90	349.49	361.18	372.95	+ 2.9	+ 2.8	+ 3.3	+ 3.3

Source: WIFO. 2017 and 2018: forecast. – <sup>1</sup> Including non-profit institutions serving households. – <sup>2</sup> Including weapon systems. – <sup>3</sup> Mainly intellectual property products (research and development, computer programmes, copyrights).

Import growth in 2016 was on the one hand supported by stronger domestic demand, notably investment in machinery and equipment, but on the other hand dampened by sluggish exports (which have a high import content). Net exports provided altogether a negative contribution to GDP growth. With investment levelling off in 2017, domestically-driven import growth may decelerate, but stimulus from higher exports should strengthen. The pace of imports may fall behind that of exports, yielding a positive growth contribution of net exports. The same pattern should hold in 2018. The trade balance is expected to weaken in nominal terms in 2017 due to price effects, inter alia the rise in raw material prices.

### 3.3 Employment growth gaining momentum

Labour supply will keep rising strongly over the entire forecast period. Several factors play a role in this context: the rise in the labour force participation rate of older workers as a result of past reforms of the pension system, and of female workers; the persisting arrival of foreign workers as part of the traditional migration flows; and the yet unknown number of asylum seekers and persons in subsidiary protection to be granted access to the Austrian labour market – their number among the registered unemployed and job trainees rose by 7,700 in 2016.

The rebound of GDP growth will boost overall employment, as confirmed by the recent strong increase in new jobs as well as in the number of vacancies. Against this background, the present forecast revises this year's growth of active dependent employment strongly upwards, to +56,000 or +1.6 percent. The sheer carry-over from 2016 yields an increase of around 30,000 new jobs in 2017. Job creation should continue at a healthy pace of +45,000 or +1.3 percent in 2018.

*The cyclical upswing is accompanied by strong employment growth. Since labour supply also keeps rising rapidly, the jobless rate will ease only slightly in 2017 and remain flat in 2018.*

Table 8: Labour market

	2013	2014	2015	2016	2017	2018
	Change from previous year in 1,000					
<i>Demand for labour</i>						
Persons in active employment <sup>1</sup>	+ 29.2	+ 31.8	+ 42.5	+ 60.1	+ 64.0	+ 53.0
Employees <sup>1,2</sup>	+ 21.2	+ 23.8	+ 33.2	+ 53.7	+ 56.0	+ 45.0
National employees	- 8.5	- 8.1	+ 6.3	+ 17.7	+ 19.0	+ 15.0
Foreign employees	+ 29.7	+ 32.0	+ 27.0	+ 36.0	+ 37.0	+ 30.0
Self-employed <sup>3</sup>	+ 8.0	+ 8.0	+ 9.3	+ 6.4	+ 8.0	+ 8.0
<i>Labour supply</i>						
Population of working age						
15 to 64 years	+ 23.5	+ 33.1	+ 52.3	+ 68.9	+ 42.0	+ 35.3
Labour force <sup>4</sup>	+ 55.8	+ 64.0	+ 77.5	+ 63.1	+ 61.0	+ 57.0
<i>Labour surplus</i>						
Unemployed <sup>5</sup>	+ 26.6	+ 32.2	+ 35.0	+ 3.0	- 3.0	+ 4.0
Unemployed persons in training	+ 6.9	+ 1.8	- 10.2	+ 2.1	+ 6.0	+ 3.0
	Percent					
<i>Unemployment rate</i>						
As a percentage of total labour force (Eurostat) <sup>6</sup>	5.4	5.6	5.7	6.0	5.9	5.9
As a percentage of total labour force <sup>5</sup>	6.8	7.4	8.1	8.1	7.9	7.9
As a percentage of dependent labour force <sup>5</sup>	7.6	8.4	9.1	9.1	8.9	8.9
	Percentage changes from previous year					
Labour force <sup>4</sup>	+ 1.4	+ 1.5	+ 1.8	+ 1.5	+ 1.4	+ 1.3
Persons in active dependent employment <sup>1,2</sup>	+ 0.6	+ 0.7	+ 1.0	+ 1.6	+ 1.6	+ 1.3
Unemployed <sup>5</sup>	+ 10.2	+ 11.2	+ 11.0	+ 0.8	- 0.8	+ 1.1
Persons (in 1,000)	287.2	319.4	354.3	357.3	354.3	358.3

Source: WIFO. 2017 and 2018: forecast. – <sup>1</sup> Excluding persons with valid employment contract receiving child care benefit or being in military service. – <sup>2</sup> According to the Organisation of Austrian Social Security. – <sup>3</sup> According to WIFO, including liberal professions and unpaid family workers. – <sup>4</sup> Persons in active employment plus unemployed. – <sup>5</sup> According to Public Employment Service Austria. – <sup>6</sup> Labour Force Survey.

Thanks to lively labour demand, the number of unemployed (unadjusted) has been declining since November 2016, and the one of domestic jobseekers already since April 2016. The downward trend is expected to extend into 2017 and 2018. The projection for the registered unemployment figure has been corrected to a fall by 3,000

persons on average 2017. The jobless rate will edge down to 8.9 percent in 2017 and remain broadly constant in 2018.

### 3.4 Inflation accelerates markedly

Inflation, as measured by the Consumer Price Index, is expected to rise from 0.9 percent in 2016 to 1.7 percent each in 2017 and 2018. Both external and domestic factors contribute to the acceleration. Import prices of raw materials and of finished goods are on the rise. In Austria, the increase in the reduced VAT rate in the context of the latest tax reform and the pick-up of domestic demand exert upward pressure on prices. Moreover, the output gap, although not entirely closing, will narrow significantly over the forecast horizon, thereby weakening the inflation-dampening impact inherent in under-utilised production capacity. On the other hand, growth of real wages per hour worked will further lag behind productivity gains, such that wage cost should not add to inflation pressure.

Both internal and external factors are determining the dynamics of inflation. Over the entire projection period, headline inflation will be higher than in the last few years.

Table 9: Productivity

	2013	2014	2015	2016	2017	2018
	Percentage changes from previous year					
<i>Total economy</i>						
Real GDP	+ 0.1	+ 0.6	+ 1.0	+ 1.5	+ 2.0	+ 1.8
Hours worked <sup>1</sup>	- 0.6	+ 0.3	- 0.6	+ 0.9	+ 1.1	+ 0.9
Productivity <sup>2</sup>	+ 0.7	+ 0.3	+ 1.6	+ 0.6	+ 0.8	+ 0.8
Employment <sup>3</sup>	+ 0.5	+ 1.0	+ 0.7	+ 1.2	+ 1.3	+ 1.1
<i>Manufacturing</i>						
Production <sup>4</sup>	+ 0.3	+ 1.6	+ 1.8	+ 1.7	+ 3.6	+ 2.9
Hours worked <sup>5</sup>	- 1.1	- 0.0	+ 0.3	+ 0.5	+ 0.8	+ 0.2
Productivity <sup>2</sup>	+ 1.4	+ 1.6	+ 1.5	+ 1.1	+ 2.8	+ 2.7
Employees <sup>6</sup>	- 0.6	+ 0.3	+ 0.7	+ 1.0	+ 1.2	+ 0.6

Source: WIFO. 2017 and 2018: forecast. – <sup>1</sup> Total hours worked by persons employed, National Accounts definition. – <sup>2</sup> Production per hour worked. – <sup>3</sup> Employees and self-employed, National Accounts definition (jobs). – <sup>4</sup> Gross value added, volume. – <sup>5</sup> Total hours worked by employees. – <sup>6</sup> National Accounts definition (jobs).

Table 10: Earnings, international competitiveness

	2013	2014	2015	2016	2017	2018
	Percentage changes from previous year					
<i>Wages and salaries per employee<sup>1</sup></i>						
Nominal, gross	+ 1.9	+ 1.7	+ 1.7	+ 1.4	+ 1.6	+ 1.8
Real <sup>2</sup>						
Gross	- 0.1	- 0.0	+ 0.8	+ 0.5	- 0.1	+ 0.1
Net	- 0.6	- 0.6	+ 0.2	+ 3.0	- 0.2	- 0.3
<i>Wages and salaries per hour worked<sup>1</sup></i>						
Real, net <sup>2</sup>	+ 0.3	- 0.2	+ 1.7	+ 3.3	+ 0.3	+ 0.2
	Percent					
Wage share, adjusted <sup>3</sup>	68.6	70.2	69.5	69.2	69.0	68.7
	Percentage changes from previous year					
<i>Unit labour costs, nominal<sup>4</sup></i>						
Total economy	+ 2.1	+ 1.8	+ 1.7	+ 1.2	+ 1.2	+ 1.4
Manufacturing	+ 2.2	+ 0.9	+ 1.2	+ 0.9	- 0.4	- 0.2
<i>Effective exchange rate – manufactured goods<sup>5</sup></i>						
Nominal	+ 1.8	+ 1.2	- 2.7	+ 1.1	- 0.5	+ 1.8
Real	+ 2.2	+ 1.5	- 2.7	+ 1.3	- 0.8	+ 2.2

Source: WIFO. 2017 and 2018: forecast. – <sup>1</sup> National Accounts definition. – <sup>2</sup> Deflated by CPI. – <sup>3</sup> Compensation of employees as a percentage of national income, adjusted for the change in the share of employees in total employment from base year 1995. – <sup>4</sup> Labour costs in relation to productivity (hourly compensation per employees divided by GDP per employed persons' hours worked). – <sup>5</sup> Weighted by exports and imports, real value adjusted by relative HCPI.

#### 4. The risk environment

Along with the projection of developments deemed most likely (baseline scenario), the assessment of qualitative and quantitative risks is a key component of any forecast. Such an assessment concerns not only the exogenous assumptions, but also other elements of uncertainty surrounding the point estimates. For some indicators, we therefore supplement our point estimates with calculations of margins of uncertainty (Figure 3).

Figure 3: Margins of uncertainty for GDP, CPI and unemployment rate



Source: WIFO. Margins of uncertainty calculated on the basis of ex-post revealed forecast errors.

The internal risk factors for 2017 and 2018 mainly relate to the implementation of the measures adopted with the work programme of the Austrian federal government of early 2017. These measures have not been taken on board for the present forecast, although they may to a large part take effect in 2018. Their impact on the labour market should on the whole be positive, such that employment in 2018 may be higher and unemployment correspondingly lower than in the baseline scenario. In this respect, also private consumption and domestic output are subject to an upward risk. On the demand side, the impact of the incremental investment premium ("Investitionszuwachsprämie") for large companies and the possibility of advance depreciation on investment give rise to heightened uncertainty. These fiscal measures are also not included in the present forecast; past experience would suggest certain positive effects of advance depreciation, but less so for the incremental investment premium. Overall, from the assessment of the internal forecast risks one may conclude that the expected acceleration of GDP growth could turn out even stronger. For the government finances, however, the measures envisaged constitute a substantial negative risk. In particular it is unclear whether and how the additional budgetary cost of a total 4 billion € should be counter-financed.

As far as the external environment is concerned, the downside risks clearly dominate. A number of uncertainties overshadow the outlook for global business activity, such as the future course of economic policy in the USA, the UK withdrawal from the EU and the rise of protectionism within and outside the EU. The economic recovery in some commodity-exporting emerging market countries may turn out more feeble than anticipated, and geo-political tensions may flare up again and dampen global growth. On the other hand, the present forecast is rather cautious for Austrian exports in relation to the expected foreign market growth. The latter may thus allow a relatively stronger export performance and, as a consequence, stimulate domestic investment and GDP beyond the path described by the baseline scenario.