

WIFO

A-1103 WIEN, POSTFACH 91
TEL. 798 26 01 • FAX 798 93 86

 **ÖSTERREICHISCHES INSTITUT FÜR
WIRTSCHAFTSFORSCHUNG**

**Cyclical Recovery of Investment
Economic Outlook for 2006 and 2007**

December 2005

Cyclical Recovery of Investment

Economic Outlook for 2006 and 2007

Markus Marterbauer

Austrian Institute of Economic Research

December 2005

Cyclical Recovery of Investment

Economic Outlook for 2006 and 2007

Austria's economy is expected to grow by 2.4 percent in volume in 2006. Exports and gross fixed capital formation will sustain the cyclical recovery, while private household demand will hardly pick up from its current weakness. Inflation should decelerate, leading to moderate real income gains. The increase in budgetary funds for active labour market policy will prevent unemployment from rising further, but will, together with higher spending on other items, widen the government deficit.

The domestic export industries have seen a marked revival of activity since last summer. Austria is benefiting mainly from established supply relations with industrial manufacturers in Germany and other European countries which take advantage of continued strong global growth, rising demand from oil-exporting countries and the depreciation of the euro vis-à-vis the dollar. The momentum of merchandise exports should further increase to a rate of 6½ percent in volume in 2006, on account of additional demand stimulus from Germany. The rise in the standard VAT rate from 16 to 19 percent as from 1 January 2007 will lead to sizeable front-loading of purchases of durable consumer goods, notably of motor cars. The boom of German car manufacturers will strongly boost orders of the high-performing Austrian suppliers. Thus, the domestic manufacturing sector may enjoy an increase in its value added by 4.3 percent in volume in 2006.

For the further cyclical course it will be decisive whether the profits of exporting firms will be channelled into higher investment. First positive signs in that direction can be observed: the WIFO investment survey of autumn 2005 suggests that sentiment has turned around in the automobile and the steel industry as well as in machinery and industrial plant construction, with firms no longer deferring investment projects but planning their implementation. Corporate spending on machinery and equipment may go up by 3 percent in 2006 from last year. Likewise, the construction industry is

optimistic in judging its order situation, such that construction investment is expected to expand by 2.5 percent in 2006.

The current recovery may translate into a sustained cyclical upswing provided that the upward trend spills over to private household income and consumer demand. In that respect, no indications have appeared so far, even if pre-Christmas retail sales have been reported lively¹⁾. Private consumption has been growing by only 1 percent per year in volume since 2000, half the rate corresponding to the long-term average. The main reasons have been the small gains in real earnings and the rise in the saving ratio, which attained 9.4 percent of household disposable income in 2005. In 2006 and 2007, consumer demand is projected to gain nearly 2 percent, respectively, deemed insufficient as to act as a strong driver of overall growth. The moderate increase in consumption will be supported by higher wage settlements and decelerating inflation. Headline inflation is expected at 1.9 percent both in 2006 and 2007, on the assumption of oil prices on world markets stabilising. Spill-over effects of higher energy prices onto prices of other goods and services have so far been largely absent.

The number of persons in active employment will continue to rise strongly, by a projected 34,000 in 2006. Half of the increase is accounted for by foreign labour. In addition, service jobs for women, many of them part-time, will post further substantial gains. Nevertheless, job opportunities will also become brighter in sectors where full-time jobs for men prevail, such as in construction where overall employment is set to rise for the first time since 1997. Only few jobs will be lost in manufacturing in 2006, but the strong increase in output will be accommodated by substantial gains in hourly productivity (+4½ percent per year). For 2006, government funds for active labour market policy are envisaged to increase by one-third. As a consequence, the number of people in labour market training will go up by around 10,000 on annual average. Raising the qualification levels of the unemployed, notably among women re-entering the labour force and of young school-leavers, is important and efforts to

¹⁾ Wüger, M., "Konsumnachfrage in Österreich weiterhin verhalten – Zuwächse im Weihnachtsgeschäft" (Consumer Demand In Austria Remaining Subdued – Gains in pre-Christmas Sales), WIFO-Monatsberichte, 2005, 78(12), pp. 821-833, http://publikationen.wifo.ac.at/pls/wifosite/wifosite.wifo_search.get_abstract_type?p_language=2&pubid=25846.

that effect should continue beyond 2006. Since participants in training organised by the labour market service are not counted as unemployed, the jobless rate is not expected to increase further. It will remain at the high level of 7.2 percent of the dependent labour force (according to the conventional national definition) or 5.2 percent of the total labour force (Eurostat definition).

The general government deficit is likely to be kept below the threshold of 2 percent of GDP in 2006. Although spending on personnel, retirement benefits, labour market, research and education will increase, revenues from profit taxes will exceed the budgetary plans and a reform of public administration will help save costs. A draft for the 2007 Federal budget has not yet been presented. From the perspective of the cyclical scenario and assuming a restrictive stance for public expenditure, the general government deficit should be expected in the order of 1½ percent of GDP.

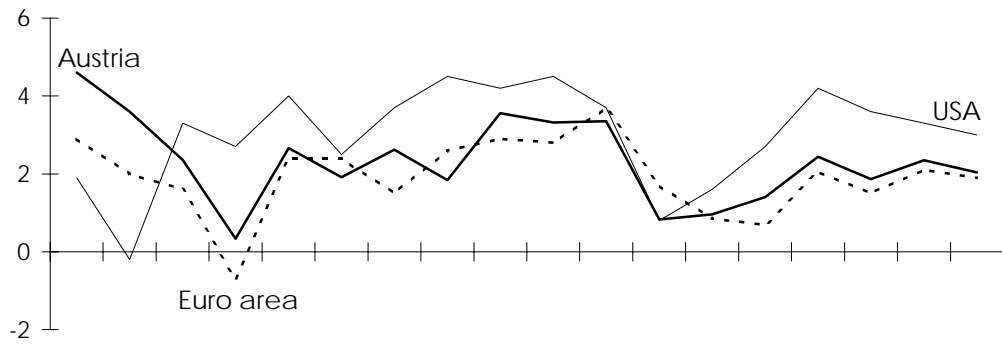
Short-term risks for the WIFO projections derive from the volatility of oil prices and the exchange rate of the euro to the dollar. The front-loading of private spending in Germany ahead of the VAT increase and one-off events in Austria (such as the take-over of the Council presidency in the EU in the first semester) will provide stimulus to GDP growth in 2006. The subsequent year may see a reverse echo-effect, exacerbated by the need to cut the high government deficit. The outlook for GDP growth in 2007, tentatively projected at around 2 percent, is necessarily vague at the present stage. The cyclical momentum may prove stronger than assumed, if investment were to accelerate to a boom, public spending to provide further incentives to qualification and research, if private household disposable income would post substantial gains and consumer demand pick up from its protracted sluggishness.

Vienna, 16 January 2006.

For more details, please refer to Markus Marterbauer, Tel. (1) 798 26 01/303, e-mail address Markus.Marterbauer@wifo.ac.at.

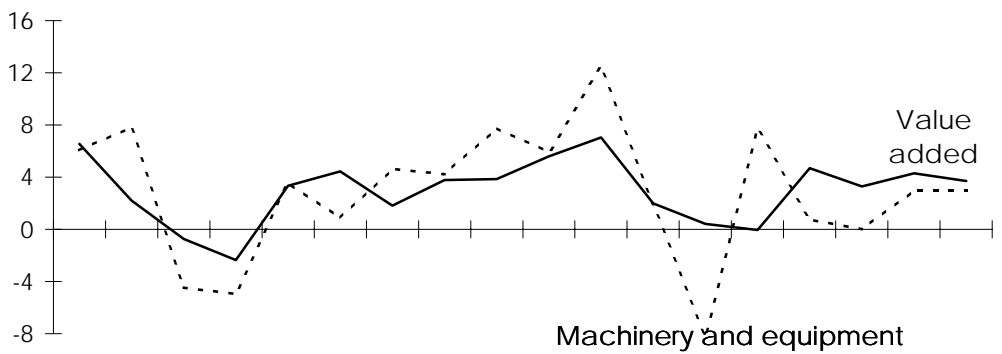
Growth of real GDP

Percent



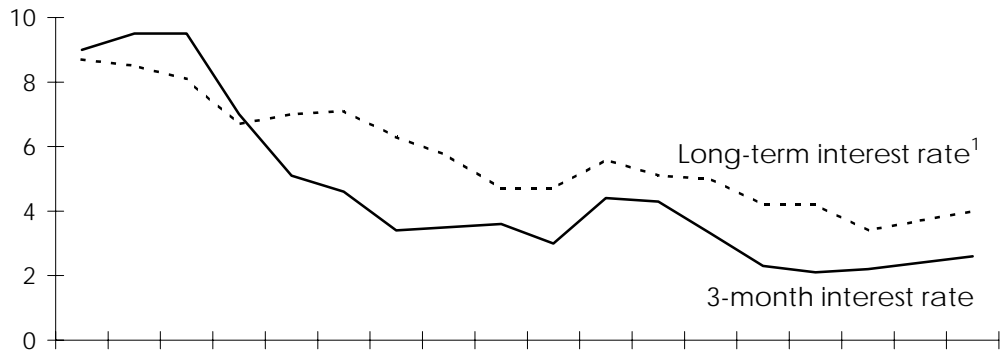
Manufacturing and investment

Percentage changes from previous year, volume



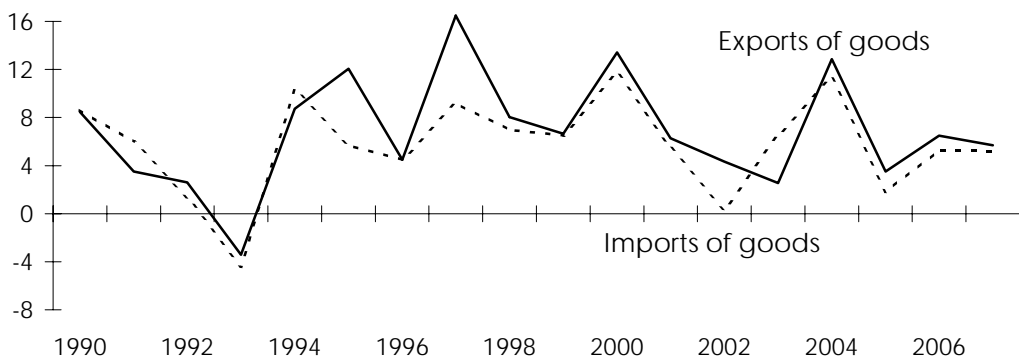
Short-term and long-term interest rates

Percent



Trade

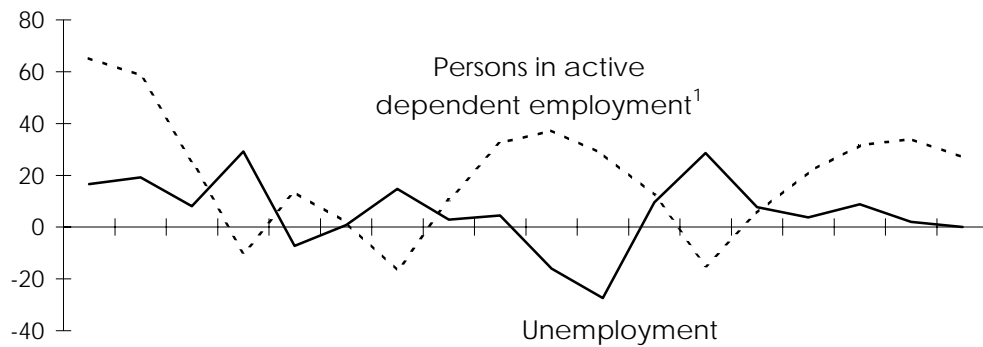
Percentage changes from previous year, volume



¹ 10-year central government bonds (benchmark).

Employment and unemployment

1,000^s from previous year



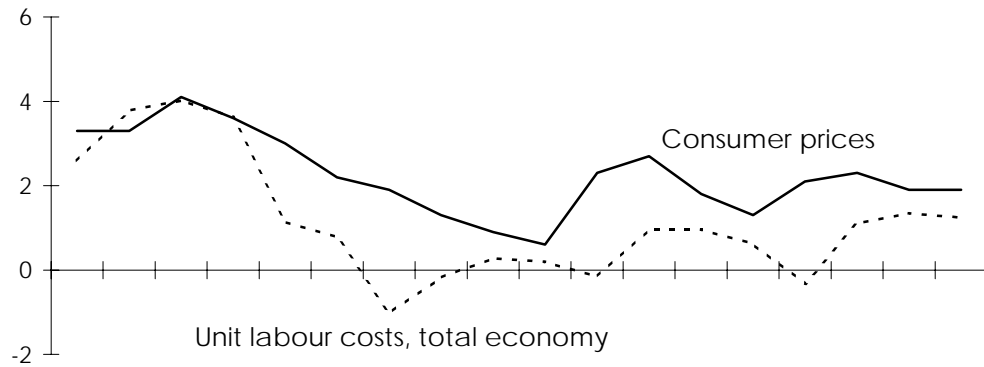
Consumption and income

Percentage changes from previous year, volume



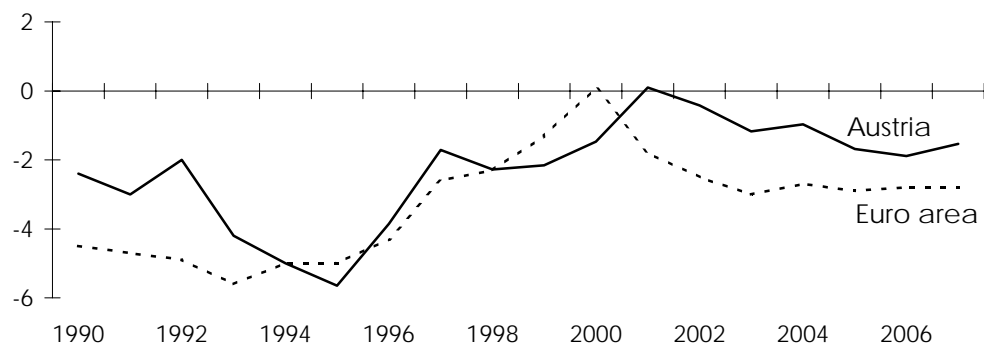
Inflation and unit labour costs

Percentage changes from previous year



General government financial balance

As a percentage of GDP



¹ Excluding parental leave, military service, and unemployed persons in training.

WIFO

Projections - December 2005

Main results

Percentage changes from previous year

		2002	2003	2004	2005	2006	2007
GDP							
Volume		+ 1.0	+ 1.4	+ 2.4	+ 1.9	+ 2.4	+ 2.0
Value		+ 2.2	+ 2.8	+ 4.4	+ 3.7	+ 4.3	+ 3.9
Manufacturing¹ , volume		+ 0.4	- 0.1	+ 4.6	+ 3.3	+ 4.3	+ 3.7
Wholesale and retail trade , volume		+ 2.0	+ 0.3	+ 1.9	+ 0.9	+ 1.8	+ 1.9
Private consumption expenditure , volume		+ 0.3	+ 1.6	+ 0.8	+ 1.4	+ 1.8	+ 2.0
Gross fixed investment , volume		- 5.0	+ 6.1	+ 0.6	+ 0.8	+ 2.7	+ 2.4
Machinery and equipment ²		- 8.2	+ 7.7	+ 0.8	± 0.0	+ 3.0	+ 3.0
Construction		- 2.3	+ 4.8	+ 0.5	+ 1.5	+ 2.5	+ 2.0
Exports of goods³							
Volume		+ 4.3	+ 2.6	+ 12.9	+ 3.5	+ 6.5	+ 5.7
Value		+ 4.2	+ 1.9	+ 13.9	+ 4.8	+ 7.4	+ 6.2
Imports of goods³							
Volume		+ 0.3	+ 6.5	+ 11.4	+ 1.8	+ 5.3	+ 5.2
Value		- 2.0	+ 5.0	+ 12.5	+ 4.8	+ 6.6	+ 6.0
Current balance	€ bn	+ 0.75	- 0.48	+ 0.58	- 0.17	+ 0.70	+ 0.67
	as a percentage of GDP	+ 0.3	- 0.2	+ 0.2	- 0.1	+ 0.3	+ 0.3
Long-term interest rate⁴	percent	5.0	4.2	4.2	3.4	3.7	4.0
Consumer prices		+ 1.8	+ 1.3	+ 2.1	+ 2.3	+ 1.9	+ 1.9
Unemployment rate							
Eurostat definition ⁵	percent	4.2	4.3	4.8	5.2	5.2	5.2
National definition ⁶	percent	6.9	7.0	7.1	7.2	7.2	7.2
Persons in active dependent employment⁷		- 0.5	+ 0.2	+ 0.7	+ 1.0	+ 1.1	+ 0.9
General government financial balance							
	according to Maastricht definition						
	as a percentage of GDP	- 0.4	- 1.2	- 1.0	- 1.7	- 1.9	- 1.5

¹ Value added, including mining and quarrying. ² Including other products. ³ According to Statistics Austria.

⁴ 10-year central government bonds (benchmark). ⁵ According to Eurostat Labour Force Survey. ⁶ According to Labour Market Service, percent of total labour force excluding self employed. ⁷ Excluding parental leave, military service, and unemployed persons in training.

WIFO*Projections - December 2005***Key policy indicators**

	2002	2003	2004	2005	2006	2007
<i>Fiscal policy</i>						
	As a percentage of GDP					
General government financial balance						
according to Maastricht definition	- 0.4	- 1.2	- 1.0	- 1.7	- 1.9	- 1.5
according to National accounts	- 0.6	- 1.3	- 1.1	- 1.8	- 2.0	- 1.6
General government primary balance	+ 2.7	+ 1.7	+ 1.9	+ 1.1	+ 0.8	+ 1.2
<i>Monetary policy</i>						
	Percent					
3-month interest rate	3.3	2.3	2.1	2.2	2.4	2.6
Long-term interest rate ¹	5.0	4.2	4.2	3.4	3.7	4.0
	Percentage changes from previous year					
Effective exchange rate						
Nominal	+ 1.4	+ 3.8	+ 1.2	- 0.5	- 0.6	- 0.2
Real	+ 0.6	+ 2.8	+ 0.9	- 0.7	- 1.0	- 0.3

¹ 10-year central government bonds (benchmark).

WIFO

Projections - December 2005

World economy

Percentage changes from previous year

	2002	2003	2004	2005	2006	2007
Real GDP						
Total OECD	+ 1.5	+ 2.0	+ 3.3	+ 2.6	+ 2.9	+ 2.7
USA	+ 1.6	+ 2.7	+ 4.2	+ 3.6	+ 3.3	+ 3.0
Japan	- 0.3	+ 1.4	+ 2.7	+ 2.2	+ 2.3	+ 2.5
EU 25	+ 1.2	+ 1.2	+ 2.4	+ 1.7	+ 2.2	+ 2.0
EU 15	+ 1.1	+ 1.1	+ 2.3	+ 1.6	+ 2.1	+ 1.9
Euro area	+ 0.9	+ 0.7	+ 2.1	+ 1.5	+ 2.1	+ 1.9
Germany	+ 0.1	- 0.2	+ 1.6	+ 1.1	+ 1.9	+ 1.2
New members ¹	+ 2.6	+ 3.8	+ 5.1	+ 4.3	+ 4.0	+ 4.0
China	+ 8.3	+ 9.3	+ 9.5	+ 9.3	+ 9.0	+ 9.0
World trade, volume	+ 3.4	+ 4.8	+ 7.9	+ 7.3	+ 8.5	+ 8.0
Market growth²	+ 1.8	+ 5.1	+ 8.4	+ 5.0	+ 6.3	+ 5.5
Primary commodity prices						
HWWA Index, total	- 5	- 4	+ 18	+ 39	+ 10	+ 11
Excluding energy	- 6	- 6	+ 18	+ 10	+ 15	+ 8
Crude oil prices						
Average import price (cif) for OECD countries	24.1	28.4	36.3	57.0	57.0	62.0
Exchange rate						
USD per euro	0.945	1.131	1.243	1.250	1.16	1.12

¹ Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia.

² Real import growth of trading partners weighted by Austrian export shares.

WIFO

Projections - December 2005

Private consumption, income and prices

	2002	2003	2004	2005	2006	2007
	Percentage changes from previous year, volume					
Private consumption expenditure	+ 0,3	+ 1,6	+ 0,8	+ 1,4	+ 1,8	+ 2,0
Durables	+ 0,3	+ 3,2	+ 0,6	+ 2,0	+ 2,4	+ 2,2
Non-durables and services	+ 0,3	+ 1,5	+ 0,8	+ 1,3	+ 1,7	+ 2,0
Household disposable income	+ 0,7	+ 2,3	+ 1,2	+ 1,9	+ 1,9	+ 1,8
Household saving ratio						
As a percentage of disposable income	7,7	8,6	9,0	9,4	9,5	9,4
	Percentage changes from previous year					
Direct lending to domestic non-banks¹	+ 1,2	+ 1,6	+ 5,0	+ 4,4	+ 2,8	+ 3,3
	Percentage changes from previous year					
Inflation rate						
National	1,8	1,3	2,1	2,3	1,9	1,9
Harmonised	1,7	1,3	2,0	2,2	1,9	1,9
Core inflation ²	2,0	1,3	1,6	1,5	1,6	1,6

¹ End of period.

² Excluding unprocessed food (meat, fish, fruits, vegetables) and energy items.

Productivity

Percentage changes from previous year

	2002	2003	2004	2005	2006	2007
Total economy						
Real GDP	+ 1.0	+ 1.4	+ 2.4	+ 1.9	+ 2.4	+ 2.0
Employment ¹	- 0.1	+ 0.1	- 0.0	+ 0.6	+ 0.9	+ 0.8
Productivity (GDP per employment)	+ 1.1	+ 1.3	+ 2.5	+ 1.3	+ 1.4	+ 1.2
Manufacturing						
Production ²	+ 0.4	- 0.0	+ 4.7	+ 3.3	+ 4.3	+ 3.7
Employees ³	- 2.5	- 1.7	- 0.6	- 0.9	- 0.5	- 0.8
Productivity per hour	+ 3.5	+ 1.3	+ 4.4	+ 4.6	+ 4.6	+ 4.9
Working hours per day per employee ⁴	- 0.5	+ 0.3	+ 0.8	- 0.3	+ 0.2	- 0.3

¹ Dependent and self-employed according to National Accounts definition.

² Value added, volume.

³ According to Federation of Austrian Social Security Institutions.

⁴ According to 'Konjunkturerhebung' of Statistics Austria.

WIFO

Projections - December 2005

Earnings and international competitiveness

Percentage changes from previous year

	2002	2003	2004	2005	2006	2007
Gross earnings per employee ¹	+ 2.2	+ 1.9	+ 2.0	+ 2.4	+ 2.8	+ 2.5
Gross real earnings per employee ¹	+ 1.2	+ 0.4	+ 0.0	+ 0.1	+ 0.9	+ 0.6
Net real earnings per employee ¹	+ 1.0	+ 0.1	+ 0.3	+ 1.0	+ 0.6	+ 0.3
<i>Total economy</i>						
Unit labour costs	+ 1.0	+ 0.6	- 0.3	+ 1.1	+ 1.3	+ 1.2
<i>Manufacturing</i>						
Unit labour costs	- 0.3	- 0.1	- 3.5	- 1.3	- 1.7	- 1.7
Relative unit labour costs ²						
Vis-à-vis trading partners	- 0.6	+ 2.9	- 0.8	- 1.1	- 1.0	- 1.5
Vis-à-vis Germany	- 1.5	+ 1.5	+ 0.3	+ 0.1	+ 0.2	- 1.2
Effective exchange rate - manufactures						
Nominal	+ 1.3	+ 3.7	+ 1.2	- 0.5	- 0.5	- 0.2
Real	+ 0.8	+ 2.9	+ 1.0	- 0.5	- 0.9	- 0.2

¹ Employees according to National Accounts definition.

² In a common currency; minus sign indicates improvement of competitiveness.

WIFO

Projections - December 2005

Labour market

Changes from previous year (1,000^s)

	2002	2003	2004	2005	2006	2007	
Demand for labour							
Persons in active employment ¹	- 11.6	+ 8.5	+ 25.1	+ 36.6	+ 39.5	+ 32.5	
Employees ²	- 15.0	+ 5.5	+ 21.1	+ 31.6	+ 34.0	+ 27.0	
<i>Percentage changes from previous year</i>	- 0.5	+ 0.2	+ 0.7	+ 1.0	+ 1.1	+ 0.9	
Nationals	- 20.1	- 10.4	+ 9.2	+ 19.6	+ 17.0	+ 13.0	
Foreign workers	+ 5.1	+ 15.9	+ 11.9	+ 12.0	+ 17.0	+ 14.0	
Self-employed ³	+ 3.4	+ 3.0	+ 4.0	+ 5.0	+ 5.5	+ 5.5	
Labour supply							
Population of working age (15 to 64 years)	+ 42.9	+ 37.7	+ 34.4	+ 12.7	+ 9.0	+ 20.2	
(15 to 59 years)	+ 13.4	+ 21.2	+ 35.6	+ 45.7	+ 40.5	+ 24.9	
Labour force ⁴	+ 17.0	+ 16.1	+ 28.9	+ 45.4	+ 41.5	+ 32.5	
Surplus of labour							
Registered unemployed ⁵	+ 28.5	+ 7.7	+ 3.8	+ 8.8	+ 2.0	± 0.0	
1,000 ^s	232.4	240.1	243.9	252.7	254.7	254.7	
Unemployment rate							
Eurostat definition ⁶	percent	4.2	4.3	4.8	5.2	5.2	5.2
Percent of total labour force ⁵	percent	6.2	6.3	6.4	6.5	6.5	6.4
National definition ^{5,7}	percent	6.9	7.0	7.1	7.2	7.2	7.2
Employment rate							
Persons in active employment ^{1,8}	percent	62.5	62.2	62.3	62.8	63.4	63.7
Total employment (Eurostat) ^{6,8,9}	percent	-	-	67.8	68.0	68.2	68.4

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

⁵ According to Labour Market Service. ⁶ According to Eurostat Labour Force Survey.

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

⁹ Changed survey method.

© 2005 Österreichisches Institut für Wirtschaftsforschung

Medieninhaber (Verleger), Herausgeber und Hersteller: Österreichisches Institut für Wirtschaftsforschung,
Wien 3, Arsenal, Objekt 20 • Postanschrift: A-1103 Wien, Postfach 91 • Tel. (+43 1) 798 26 01-0 •
Fax (+43 1) 798 93 86 • <http://www.wifo.ac.at/> • Verlags- und Herstellungsort: Wien

Verkaufspreis: 15,00 € • Download 15,00 €:

http://publikationen.wifo.ac.at/pls/wifosite/wifosite.wifo_search.get_abstract_type?p_language=1&pubid=25876