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**Oil Price Hike Driving Up Inflation,
Dampening Economic Growth
Economic Outlook for 2008 and 2009**

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Markus Marterbauer

Austrian Institute of Economic Research

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Economic Outlook for 2008 and 2009

In 2008, the Austrian economy is set to grow by 2.3 percent in volume. While lively activity in manufacturing, construction and tourism boosted GDP in the first quarter more strongly than expected earlier this year, a cyclical slowdown is under way. A major factor is the unabated increase in oil prices on world markets, which drives up inflation to a projected average rate of 3.5 percent this year. The implicit squeeze in household real disposable income restrains the growth of private consumption. The business cycle downturn spreading from the USA to the other industrialised countries will weigh on growth of Austrian exports, industrial output and investment. In 2009, therefore, GDP growth is expected to moderate to 1.4 percent. Whereas employment is posting strong gains in 2008, the downward trend in unemployment may turn around next year.

The world market price for oil of type Brent rose from about 90 \$ per barrel at the beginning of the year to 135 \$ of late. Reasons have been the shift of speculation away from financial and real estate markets towards commodities, the continued rise in oil demand and the absence of a supply increase since 2005. This, together with high world market prices for food has triggered a significant acceleration of consumer price inflation. In Austria, headline inflation is likely to rise to an average 3.5 percent this year, the highest rate since 1993. In 2009, inflation is expected to abate to 2.7 percent, assuming a slower upward drift of energy and food prices.

The high rate of inflation leads to a decline in employees' real per-capita earnings by 0.7 percent and to a gain in household real disposable income by a modest 0.7 percent in 2008. Even assuming a reduction in private saving as a share of disposable income, as it is typical for periods of massive energy price hikes, the sluggish income growth will weigh on consumer demand. Private household spending will edge up by only 1.1 percent in volume in 2008, less than half the pace observed in a longer-term

perspective. In 2009, no rebound should be expected either. The service sector and small-scale manufacturers are suffering most from the reluctance of consumers to spend more. In wholesale and retail trade, value added may increase by only 1¼ percent p.a. in real terms.

Whereas private consumption levelled off in the first quarter, value added in manufacturing continued to expand strongly, by 6 percent in volume year-on-year, according to the WIFO quarterly national accounts. The industrial boom of the last two years, with a cumulated increase in value added by 16 percent, thereby continued virtually unabated. Nevertheless, in the regular WIFO business cycle survey the leading indicators signal a marked slowdown for the manufacturing sector on the back of slackening activity in key trading partner countries.

Several factors weigh on aggregate demand in the euro area, leading to a cyclical downturn:

- The US economy has been in stagnation for the last nine months; domestic demand is receding, with imports barely rising.
- The effective appreciation of the euro is dampening exports and investment in Europe.
- Credit conditions for firms and households are deteriorating.
- In Ireland and Spain, the construction and real estate crisis is going on.
- The swift rise in commodity prices is adding to inflation, thereby squeezing real disposable income and consumption by private households.

Support to business activity derives from the markedly expansionary stance of fiscal and monetary policy in the USA, the cyclically-induced widening of government deficits in the euro area and the lively domestic demand in the emerging markets. GDP in the euro area may still expand by 1¾ percent in volume this year, whereas for 2009 a slowdown to a growth rate of 1 percent should be expected. The new EU countries still enjoy buoyant domestic demand, although a deceleration is in sight as inflationary pressure and high private household indebtedness weigh on private con-

sumption. At an estimated 4.5 percent in 2009, GDP growth nevertheless remains distinctly stronger than in the EU 15.

The cyclical slowdown in the EU dampens the growth of Austrian export markets from 11 percent in 2006 to only 5.8 percent in 2008. At the same time, the substantial appreciation of the euro implies a temporary weakening of price competitiveness. Austrian goods exports should therefore grow by a more moderate 5 percent in volume this year and next, compared with 8.2 percent in 2007.

Manufacturing production has been booming in the last two years, but the weaker momentum of exports is now taking its toll. In 2008, real output is set to expand by 3.8 percent, followed by a slimmer gain of 2.2 percent in 2009. The lower capacity utilisation associated with the cyclical downturn may induce firms to a more cautious investment behaviour, despite continued satisfactory corporate earnings. This is confirmed by latest results from the regular WIFO investment survey showing that industrial investment plans for 2008 have been revised down from last autumn. Corporate spending on machinery and equipment is projected to go up by an inflation-adjusted 3 percent this year.

Higher prices for commodity inputs have so far had only a minor effect on construction output which in the first quarter has benefited from clement weather conditions. After the boom of 2006-07 with a cumulated value added increase of 8 percent in real terms, a slowdown should nevertheless be expected towards an estimated +2 percent in 2008 and somewhat lower in 2009.

From January to May, total employment grew massively, by 90,000 from the same period of last year. While this mirrors the benign cyclical conditions during the second half of 2007, it is probably also due to a significant degree to the new obligation in force since early 2008, whereby newly-hired employees have to be registered with the social security administration before taking up work. The more cyclically-determined seasonally-adjusted employment trend month-on-month has become flatter since the beginning of the year. Other factors as well point to a slackening on the labour market: thus, the number of unfilled vacancies is stagnating, and the number of unemployed, when adjusted for seasonal variations, has not declined further since February. On annual average 2008, the number of people in dependent active em-

ployment is expected to exceed the level of last year by 68,000, while registered unemployment should recede by 13,000 to a total 209,000. The cyclical slowdown under way will weaken the situation on the labour market with the usual time lag. In 2009, unemployment is likely to pick up by some 15,000 persons, yielding an unemployment rate of 6.1 percent of the dependent labour force (national definition) or 4.4 percent of the total labour force according to Eurostat definitions.

Government revenue remains on a firm upward trend. Buoyant receipts from wage tax and social contributions reflect the strong growth of employment and higher nominal wages. Indirect taxes, however, are rising more moderately despite strong inflation, on account of the persistent sluggishness in private consumption. Overall, government revenues are nevertheless exceeding budgetary plans. Despite the cut in unemployment insurance contributions and the frontloading of the increase in retirement benefits, the general government deficit may narrow to 0.6 percent of GDP in 2008. In 2009, the deficit may edge up somewhat on the back of weaker cyclical conditions.

The present projections assume a significant slowdown in economic growth during 2008, while a recession should be avoided. However, with a view to the high volatility of commodity prices, exchange rates and on financial markets and their repercussions on the real economy, extent and duration of the cyclical downturn remain highly uncertain. A turnaround of the cycle is expected as from early 2009. Should the positive impulses on business activity be delayed, GDP growth in 2009 could turn out significantly lower than anticipated in the present context.

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*For more details please contact Markus Marterbauer, Tel. (1) 798 26 01/303,
Markus.Marterbauer@wifo.ac.at*

WIFO
Projections - June 2008

Main results

Percentage changes from previous year

		2004	2005	2006	2007	2008	2009
GDP							
Volume		+ 2.3	+ 2.0	+ 3.3	+ 3.4	+ 2.3	+ 1.4
Value		+ 4.4	+ 3.9	+ 5.1	+ 5.7	+ 5.1	+ 3.8
Manufacturing¹, volume		+ 2.4	+ 3.1	+ 8.8	+ 7.2	+ 3.8	+ 2.2
Wholesale and retail trade, volume		+ 1.1	+ 0.2	+ 1.0	+ 0.7	+ 1.3	+ 1.2
Private consumption expenditure, volume		+ 1.8	+ 2.0	+ 2.1	+ 1.4	+ 1.1	+ 1.2
Gross fixed investment, volume		+ 0.1	+ 0.3	+ 3.8	+ 5.3	+ 2.4	+ 1.0
Machinery and equipment ²		- 1.4	+ 0.7	+ 2.1	+ 7.1	+ 3.0	± 0.0
Construction		+ 1.3	+ 0.1	+ 5.1	+ 3.9	+ 2.0	+ 1.7
Exports of goods³							
Volume		+ 12.5	+ 3.2	+ 6.8	+ 8.6	+ 5.0	+ 4.8
Value		+ 13.9	+ 5.4	+ 9.5	+ 10.5	+ 6.7	+ 5.8
Imports of goods³							
Volume		+ 11.7	+ 2.8	+ 3.8	+ 8.5	+ 4.3	+ 4.3
Value		+ 12.5	+ 5.9	+ 8.0	+ 9.6	+ 7.3	+ 5.7
Current balance	€ bn	+ 4.84	+ 4.92	+ 6.29	+ 8.76	+ 8.03	+ 7.71
	as a percentage of GDP	+ 2.1	+ 2.0	+ 2.4	+ 3.2	+ 2.8	+ 2.6
Long-term interest rate⁴	percent	4.2	3.4	3.8	4.3	4.4	4.4
Consumer prices		+ 2.1	+ 2.3	+ 1.5	+ 2.2	+ 3.5	+ 2.7
Unemployment rate							
Eurostat definition ⁵	percent	4.8	5.2	4.7	4.4	4.2	4.4
National definition ⁶	percent	7.1	7.3	6.8	6.2	5.8	6.1
Persons in active dependent employment⁷		+ 0.7	+ 1.0	+ 1.7	+ 2.1	+ 2.1	+ 0.5
General government financial balance							
according to Maastricht definition							
as a percentage of GDP		- 3.7	- 1.5	- 1.5	- 0.5	- 0.6	- 0.7

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 Public Employment Service Austria, percent of total labour force excluding self employed. ⁷ Excluding parental leave, military service, and unemployed persons in training.

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Key policy indicators

	2004	2005	2006	2007	2008	2009
Fiscal policy						
	As a percentage of GDP					
General government financial balance						
according to Maastricht definition	- 3.7	- 1.5	- 1.5	- 0.5	- 0.6	- 0.7
according to National accounts	- 3.9	- 1.6	- 1.6	- 0.7	- 0.7	- 0.8
General government primary balance	- 0.9	+ 1.4	+ 1.2	+ 2.2	+ 2.1	+ 2.0
Monetary policy						
	Percent					
3-month interest rate	2.1	2.2	3.1	4.3	4.8	4.8
Long-term interest rate ¹	4.2	3.4	3.8	4.3	4.4	4.4
	Percentage changes from previous year					
Effective exchange rate						
Nominal	+ 1.5	- 0.7	+ 0.2	+ 1.1	+ 2.3	+ 0.5
Real	+ 1.0	- 1.0	- 0.6	+ 0.8	+ 2.2	+ 0.7

¹ 10-year central government bonds (benchmark).

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World economy

Percentage changes from previous year

	2004	2005	2006	2007	2008	2009
Real GDP						
World	+ 4.9	+ 4.4	+ 5.0	+ 4.9	+ 4.0	+ 3.5
Total OECD	+ 3.1	+ 2.4	+ 3.0	+ 2.7	+ 1.6	+ 1.4
USA	+ 3.6	+ 3.1	+ 2.9	+ 2.2	+ 1.4	+ 1.4
Japan	+ 2.7	+ 1.9	+ 2.4	+ 2.1	+ 1.6	+ 1.0
EU 27	+ 2.5	+ 1.9	+ 3.1	+ 2.8	+ 2.0	+ 1.4
Euro area 15	+ 2.1	+ 1.6	+ 2.8	+ 2.6	+ 1.7	+ 1.1
Germany	+ 1.1	+ 0.8	+ 2.9	+ 2.5	+ 2.0	+ 1.1
New member states ¹	+ 5.7	+ 4.8	+ 6.6	+ 6.2	+ 5.0	+ 4.5
China	+ 10.1	+ 10.4	+ 11.1	+ 11.4	+ 9.5	+ 8.5
World trade, volume	+ 10.6	+ 7.9	+ 8.8	+ 7.1	+ 6.3	+ 6.1
Market growth²	+ 9.4	+ 7.5	+ 11.0	+ 7.6	+ 5.8	+ 4.8
Primary commodity prices						
HWWI Index, total	+ 18.5	+ 28.5	+ 19.7	+ 3.7	+ 42	+ 6
Excluding energy	+ 18.1	+ 5.6	+ 22.0	+ 9.5	+ 24	+ 7
Crude oil prices						
Brent, USD per barrel	38.2	54.4	65.1	72.5	120.0	130.0
Exchange rate						
USD per euro	1.243	1.245	1.256	1.371	1.56	1.60

¹ Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia.

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

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Projections - June 2008

Private consumption, income and prices

	2004	2005	2006	2007	2008	2009
	Percentage changes from previous year, volume					
Private consumption expenditure	+ 1.8	+ 2.0	+ 2.1	+ 1.4	+ 1.1	+ 1.2
Durables	+ 4.0	+ 2.5	+ 1.9	+ 2.5	+ 1.3	+ 1.5
Non-durables and services	+ 1.5	+ 2.0	+ 2.1	+ 1.3	+ 1.1	+ 1.2
Household disposable income	+ 1.9	+ 2.6	+ 2.7	+ 2.4	+ 0.7	+ 0.9
Household saving ratio						
As a percentage of disposable income	8.9	9.3	9.7	10.5	10.3	10.1
	Percentage changes from previous year					
Direct lending to domestic non-banks¹	+ 5.0	+ 4.7	+ 4.5	+ 3.6	+ 3.9	+ 2.8
Inflation rate						
National	2.1	2.3	1.5	2.2	3.5	2.7
Harmonised	2.0	2.1	1.7	2.2	3.5	2.8
Core inflation ²	1.6	1.5	1.3	1.9	2.5	2.4

¹ End of period.

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

Productivity

Percentage changes from previous year

	2004	2005	2006	2007	2008	2009
Total economy						
Real GDP	+ 2.3	+ 2.0	+ 3.3	+ 3.4	+ 2.3	+ 1.4
Employment ¹	+ 0.2	+ 0.8	+ 1.2	+ 2.2	+ 1.3	+ 0.4
Productivity (GDP per employment)	+ 2.2	+ 1.2	+ 2.1	+ 1.1	+ 0.9	+ 1.0
Manufacturing						
Production ²	+ 2.3	+ 3.2	+ 8.8	+ 7.4	+ 3.8	+ 2.2
Employees ³	- 0.6	- 0.8	+ 0.2	+ 2.6	+ 0.7	- 1.2
Productivity per hour	+ 2.1	+ 4.6	+ 8.4	+ 5.0	+ 3.4	+ 3.4
Working hours per day per employee ⁴	+ 0.8	- 0.6	+ 0.2	- 0.3	- 0.3	± 0.0

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.

Earnings and international competitiveness

Percentage changes from previous year

	2004	2005	2006	2007	2008	2009
Gross earnings per employee ¹	+ 1.8	+ 2.3	+ 2.7	+ 2.7	+ 3.3	+ 3.5
Gross real earnings per employee ¹	- 0.0	+ 0.6	+ 1.1	+ 0.6	- 0.2	+ 0.8
Net real earnings per employee ¹	- 0.0	+ 1.2	+ 0.5	+ 0.1	- 0.7	+ 0.4
<i>Total economy</i>						
Unit labour costs	- 0.6	+ 1.2	+ 0.4	+ 1.5	+ 2.6	+ 2.5
<i>Manufacturing</i>						
Unit labour costs	- 0.7	- 0.0	- 4.2	- 2.0	+ 0.4	+ 0.3
Relative unit labour costs²						
Vis-à-vis trading partners	+ 2.0	+ 0.8	- 2.4	- 0.5	+ 0.7	± 0.0
Vis-à-vis Germany	+ 2.4	+ 2.6	- 1.5	+ 0.8	- 0.6	+ 0.3
Effective exchange rate - manufactures						
Nominal	+ 1.5	- 0.6	+ 0.2	+ 1.2	+ 2.2	+ 0.4
Real	+ 1.1	- 0.9	- 0.5	+ 0.8	+ 2.1	+ 0.7

¹ Employees according to National Accounts definition.

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

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Labour market

Changes from previous year (1,000^s)

	2004	2005	2006	2007	2008	2009
Demand for labour						
Persons in active employment ¹	+ 25.1	+ 37.2	+ 55.9	+ 66.9	+ 72.0	+ 20.0
Employees ²	+ 21.1	+ 31.9	+ 51.5	+ 65.5	+ 68.0	+ 18.0
<i>Percentage changes from previous year</i>	+ 0.7	+ 1.0	+ 1.7	+ 2.1	+ 2.1	+ 0.5
Nationals	+ 9.2	+ 20.0	+ 35.0	+ 43.6	+ 45.0	+ 11.0
Foreign workers	+ 11.9	+ 11.9	+ 16.5	+ 21.9	+ 23.0	+ 7.0
Self-employed ³	+ 4.0	+ 5.3	+ 4.4	+ 1.4	+ 4.0	+ 2.0
Labour supply						
Population of working age (15 to 64 years)	+ 34.4	+ 15.6	+ 18.5	+ 17.4	+ 18.0	+ 20.2
(15 to 59 years)	+ 35.6	+ 48.5	+ 52.8	+ 18.8	+ 8.5	+ 13.7
Labour force ⁴	+ 28.9	+ 45.9	+ 42.4	+ 50.0	+ 58.5	+ 35.0
Surplus of labour						
Registered unemployed ⁵	+ 3.8	+ 8.8	- 13.5	- 16.9	- 13.5	+ 15.0
1,000 ^s	243.9	252.7	239.2	222.2	208.7	223.7
Unemployment rate						
Eurostat definition ⁶	percent	4.8	5.2	4.7	4.4	4.2
Percent of total labour force ⁵	percent	6.4	6.5	6.1	5.6	5.2
National definition ^{5,7}	percent	7.1	7.3	6.8	6.2	5.8
Employment rate						
Persons in active employment ^{1,8}	percent	62.3	62.8	63.6	64.5	65.6
Total employment (Eurostat) ^{6,8,9}	percent	67.8	68.6	70.2	71.4	72.2

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.

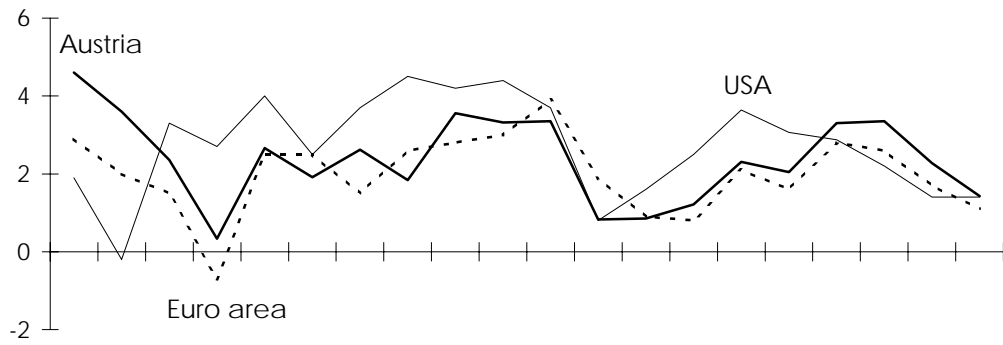
⁵ According to Public Employment Service Austria. ⁶ According to Eurostat Labour Force Survey.

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

⁹ Changed survey method.

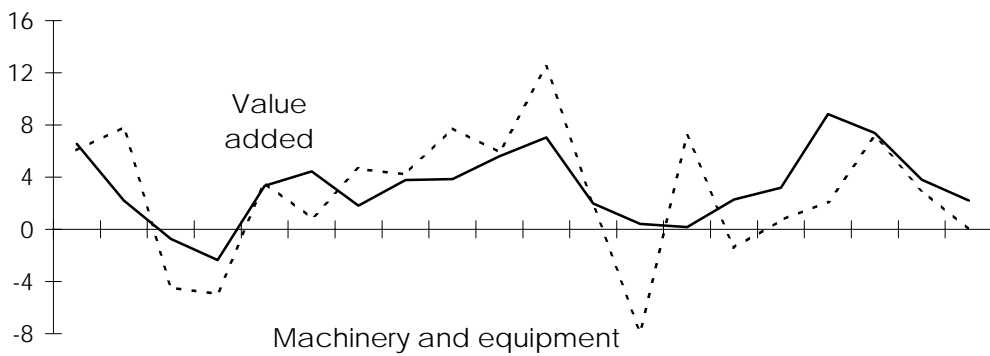
Growth of real GDP

Percent



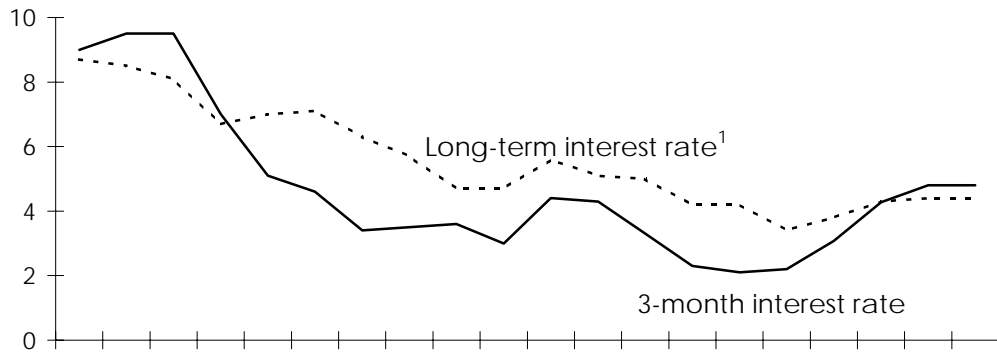
Manufacturing and investment

Percentage changes from previous year, volume



Short-term and long-term interest rates

Percent



Trade

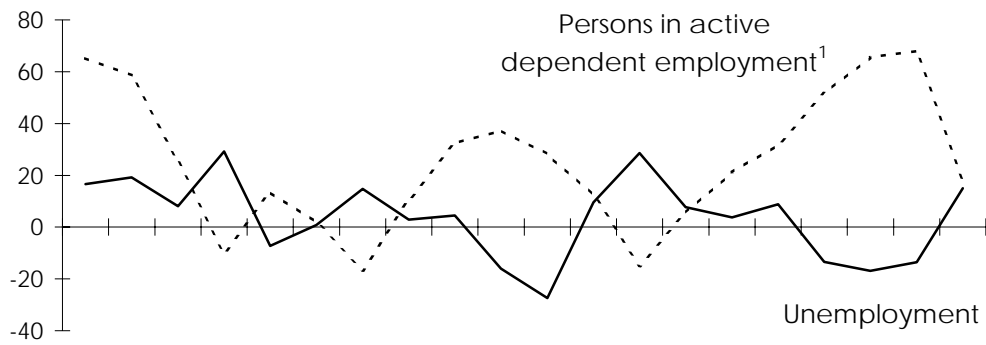
Percentage changes from previous year, volume



¹ 10-year central government bonds (benchmark).

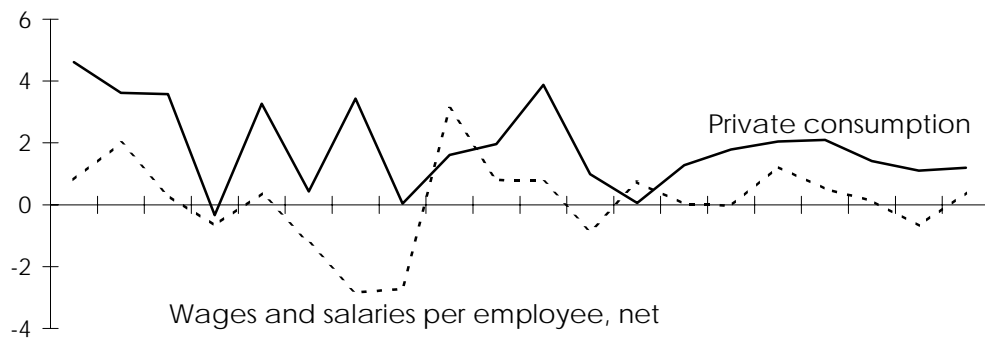
Employment and unemployment

1,000^s from previous year



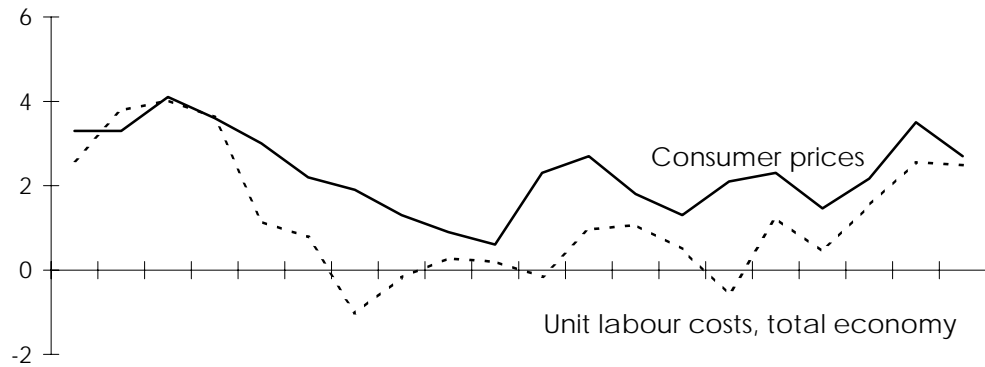
Consumption and income

Percentage changes from previous year, volume



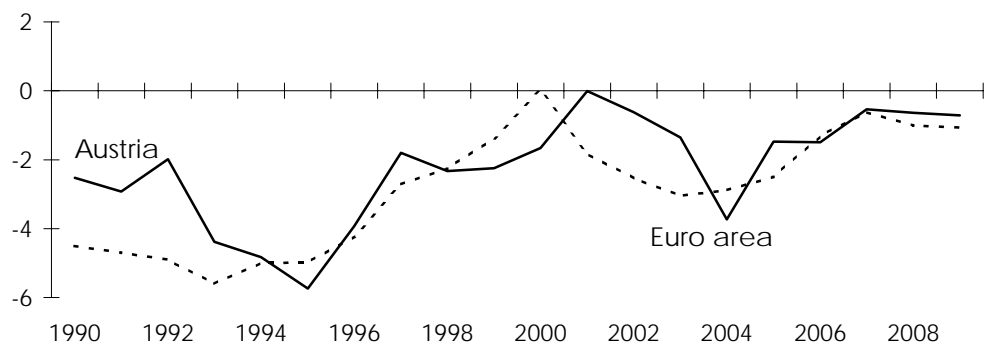
Inflation and unit labour costs

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.

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Wien 3, Arsenal, Objekt 20 • Postanschrift: A-1103 Wien, Postfach 91 • Tel. (+43 1) 798 26 01-0 •
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