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ÖSTERREICHISCHES INSTITUT FÜR WIRTSCHAFTSFORSCHUNG

Euro Area Economy Drawing Lagged Benefits from Currency Depreciation and Buoyant Global Trade

Economic Outlook for 2010 and 2011

July 2010

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AUSTRIAN INSTITUTE OF ECONOMIC RESEARCH

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Abstract

World trade rebounded further in the first few months of 2010, its volume meanwhile approaching the pre-crisis level. On the back of the boom in Asia, the recovery in the USA and the depreciation of the euro, euro area exports should make good headway. Nevertheless, the cyclical upturn will remain muted for still some time, due to sluggish domestic demand. Major risks derive from macroeconomic imbalances and financial market volatility. For Austria, WIFO expects real GDP to grow by 1.2 percent in 2010 and 1.6 percent in 2011.

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Economic Outlook for 2010 and 2011

World trade rebounded further in the first few months of 2010, its volume meanwhile approaching the pre-crisis level. On the back of the boom in Asia, the recovery in the USA and the depreciation of the euro, euro area exports should make good headway. Nevertheless, the cyclical upturn will remain muted for still some time, due to sluggish domestic demand. Major risks derive from macroeconomic imbalances and financial market volatility. For Austria, WIFO expects real GDP to grow by 1.2 percent in 2010 and 1.6 percent in 2011.

World trade rebounded further in the first few months of 2010, meanwhile nearly reaching the pre-crisis level of spring 2008. Restocking in the industrialised countries since autumn 2009 boosted commercial trade. Moreover, the unabated swift expansion in Asia kept import demand from the region at high levels. It is currently a major driver of the global recovery from which the economies of the USA and the euro area benefit through a revival of their exports.

In the USA, cyclical conditions have improved markedly since autumn 2009. Investment in machinery and equipment as well as private consumption picked up significantly. However, with the expiry of the government stimulus programmes the momentum may slow again 2011. In the euro area, internal demand has remained sluggish so far. Such time-lag vis-à-vis the USA has also been observed in earlier cyclical upturns. The trough in the euro area has typically been reached 2 to 4 quarters after the USA. This time again, the rebound in world trade and the depreciation of the euro, with the nominal-effective exchange rate down by 10 percent from the level at the beginning of the year, will sustain economic activity in the euro area.

The latest turbulences in bond markets, triggered by macroeconomic imbalances and high government debt in some countries, act as a further drag on a recovery that will be uneven across the euro area. Since early May, several countries have presented plans for fiscal retrenchment. In the Mediterranean deficit countries, these have been massive as dictated by events, weighing on growth prospects for 2010 and 2011. Nevertheless, the repercussions on the recovery in other euro area countries should remain limited.

In the other euro area countries, the rebound in world trade and the depreciation of the euro will foster the recovery. Measures of fiscal consolidation have generally been defined in only vague terms so far and are likely to turn out moderate in most cases. Consolidation measures announced in Germany amount to 0.5 percent of GDP in 2011, and should therefore not dampen aggregate demand substantially.

Despite strong exports, the cyclical recovery in the euro area will remain muted for still some time. WIFO projects real GDP growth at 0.9 percent for 2010 and 1.2 percent in 2011 – for Germany at 1.3 percent and 1.7 percent, respectively. One retarding factor is a weak recovery in private investment, which is dampened by the prevailing low capacity utilisation; another one is the persistent fragility on financial markets, which keeps uncertainty (as perceived by economic agents) high, and continues to pose downside risks. The forecast assumes that these risks will slow the momentum of recovery only to a small extent. As the global upswing proceeds and policy co-ordination among the euro area countries is improved, the danger of renewed turbulence should fade. Should private sector confidence return with progress in fiscal consolidation, the positive impulse from global growth may stimulate the euro area economy even sooner. At the same time, fiscal consolidation efforts should take into account the short-term effect on aggregate demand in the euro area, while also supposed to strengthen the long-run forces of growth.

In the Central and Eastern European countries (CEECs), economic performance will be uneven. Neighbouring CEECs will continue to benefit from the recovery in the euro area. In the countries with high private household debt (as a percentage of GDP; e.g., Hungary, Romania, the Baltics) and in the Balkan region, GDP growth is expected to remain flat at least until the end of 2010.

In 2011, the Austrian Federal government plans to introduce a consolidation package totalling € 4 billion or 1.4 percent of GDP. This will take the general government deficit ratio from 4.6 percent in 2010 to 3.8 percent in 2011. However, since the measures are not yet specified in detail, the present projections are based on tentative technical assumptions about the structure of consolidation moves.

For Austria, WIFO expects real GDP growth to accelerate from 1.2 percent in 2010 to 1.6 percent in 2011. The recovery will be driven by exports of goods as the economy benefits from the benign international environment – mainly indirectly and thus with a certain lag via exports to Germany and other euro area countries.

The small downward revision of growth for 2010 from the earlier WIFO forecast of last March is due to the weak outcome in the first quarter. For the remainder of the year, GDP is expected to edge up by an average 0.5 to 0.6 percent quarter-on-quarter.

The Austrian labour market has taken an encouraging development since the beginning of the year. Manufacturing employment has stopped falling in recent months, though being clearly down from year-earlier levels. The number of jobs keeps growing in public and quasi-public services (education and training, health and social services, administration). For the years 2010 and 2011, employment is expected to rise by 0.5 percent each. The unemployment rate will nevertheless keep shifting up somewhat until 2011, due to the simultaneous increase in labour supply.

Net real wages on a per-capita basis will edge down by 0.5 percent each in 2010 and 2011, as a result of moderate wage settlements as well as a pick-up in inflation. Mainly on account of higher import prices for crude oil, headline inflation will move up to 1.8 percent in 2010 and 2.1 percent in 2011. WIFO also assumes that in 2011 an increase in indirect taxes will add 0.4 percentage points to the inflation rate. Despite lower real wages and fiscal consolidation measures, private real disposable income may edge up slightly in both years, as a result of cyclically-induced gains in income from property and wealth. On the back of a declining saving ratio, private consumption should grow by an inflation-adjusted 0.9 percent in 2010 and 0.6 percent in 2011.

Corporate profits will normalise as the recovery gains ground. Nevertheless, the still low capacity utilisation suggests that investment will remain sluggish for some time. Firms' spending on machinery and equipment should no longer fall in the second half of the year, i.a. because of the imminent expiry of the accelerated depreciation allowance in December. The negative carry-over from 2009 and the weak first quarter will drag down the annual figure for 2010 to a 6 percent slump. Construction investment will remain subdued over the entire projection period.

Vienna, 2 July 2010

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Methodological Notes and Short Glossary

Period comparisons

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

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

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

Real and nominal values

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

Inflation, CPI und HICP

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

WIFO Business Cycle Survey and WIFO Investment Survey

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

Unemployment rate

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

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

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

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

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

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Projections - June 2010

Main results

Percentage changes from previous year

		2006	2007	2008	2009	2010	2011
GDP							
Volume		+ 3.5	+ 3.5	+ 2.0	– 3.5	+ 1.2	+ 1.6
Value		+ 5.2	+ 5.7	+ 4.1	– 1.7	+ 2.1	+ 3.3
Manufacturing[1], volume		+ 9.0	+ 7.3	+ 3.9	– 11.5	+ 3.5	+ 5.8
Wholesale and retail trade, volume		+ 0.8	+ 0.7	+ 0.6	– 3.1	+ 1.2	+ 0.7
Private consumption expenditure, volume		+ 1.8	+ 0.8	+ 0.8	+ 0.4	+ 0.9	+ 0.6
Gross fixed investment, volume		+ 2.4	+ 3.8	+ 1.0	– 8.1	– 3.2	+ 1.9
Machinery and equipment[2]		+ 2.0	+ 4.7	+ 0.1	– 10.6	– 6.0	+ 4.0
Construction		+ 2.8	+ 2.9	+ 1.8	– 6.0	– 1.0	+ 0.3
Exports of goods[3]							
Volume		+ 6.4	+ 9.0	+ 0.3	– 18.2	+ 5.8	+ 6.6
Value		+ 9.5	+ 10.5	+ 2.5	– 20.2	+ 6.6	+ 7.9
Imports of goods[3]							
Volume		+ 4.1	+ 7.6	+ 0.2	– 15.8	+ 2.8	+ 5.0
Value		+ 8.0	+ 9.6	+ 4.7	– 18.4	+ 5.4	+ 6.2
Current balance	€ bn	+ 7.26	+ 9.62	+ 9.24	+ 6.32	+ 8.05	+ 10.73
	as a percentage of GDP	+ 2.8	+ 3.6	+ 3.3	+ 2.3	+ 2.8	+ 3.7
Long-term interest rate[4]	percent	3.8	4.3	4.4	3.9	3.2	2.8
Consumer prices		+ 1.5	+ 2.2	+ 3.2	+ 0.5	+ 1.8	+ 2.1
Unemployment rate							
Eurostat definition[5]	percent	4.8	4.4	3.8	4.8	4.9	5.0
National definition[6]	percent	6.8	6.2	5.8	7.2	7.2	7.3
Persons in active dependent employment[7]		+ 1.7	+ 2.1	+ 2.4	– 1.4	+ 0.5	+ 0.5
General government financial balance							
according to Maastricht definition							
	as a percentage of GDP	– 1.5	– 0.4	– 0.4	– 3.4	– 4.6	– 3.8

[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 and military service.

Key policy indicators

	2006	2007	2008	2009	2010	2011
Fiscal policy						
	As a percentage of GDP					
General government financial balance						
according to Maastricht definition	– 1.5	– 0.4	– 0.4	– 3.4	– 4.6	– 3.8
according to National accounts	– 1.6	– 0.5	– 0.5	– 3.4	– 4.6	– 3.8
General government primary balance	+ 1.3	+ 2.3	+ 2.1	– 0.7	– 1.9	– 1.0
Monetary policy						
	Percent					
3-month interest rate	3.1	4.3	4.6	1.2	0.8	1.0
Long-term interest rate[1]	3.8	4.3	4.4	3.9	3.2	2.8
	Percentage changes from previous year					
Effective exchange rate						
Nominal	+ 0.2	+ 1.1	+ 1.2	+ 0.9	– 0.7	– 0.4
Real	– 0.5	+ 0.7	+ 0.6	+ 0.4	– 0.9	– 0.2

[1] 10-year central government bonds (benchmark).

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Projections - June 2010

World economy

Percentage changes from previous year

	2006	2007	2008	2009	2010	2011
Real GDP						
World	+ 5.2	+ 5.2	+ 2.9	– 0.9	+ 3.9	+ 3.5
USA	+ 2.7	+ 2.1	+ 0.4	– 2.4	+ 3.0	+ 2.4
Japan	+ 2.0	+ 2.4	– 1.2	– 5.2	+ 2.5	+ 1.7
EU 27	+ 3.2	+ 2.9	+ 0.8	– 4.2	+ 1.0	+ 1.4
Euro area 16	+ 3.0	+ 2.8	+ 0.6	– 4.1	+ 0.9	+ 1.2
Germany	+ 3.2	+ 2.5	+ 1.3	– 5.0	+ 1.3	+ 1.7
New member states[1]	+ 6.5	+ 6.1	+ 3.8	– 3.0	+ 1.4	+ 2.7
China	+ 11.6	+ 13.0	+ 9.7	+ 8.7	+ 10.0	+ 9.0
World trade, volume	+ 8.9	+ 7.1	+ 2.1	– 12.9	+ 12.0	+ 8.0
Market growth[2]	+ 10.6	+ 7.1	+ 3.3	– 11.4	+ 5.6	+ 6.2
Primary commodity prices						
HWWI Index, total	+ 19.7	+ 3.7	+ 22.4	– 29.2	+ 27	+ 10
Excluding energy	+ 22.0	+ 9.5	+ 15.6	– 22.7	+ 21	+ 11
Crude oil prices						
Brent, USD per barrel	65.1	72.5	97.0	61.5	76	80
Exchange rate						
USD per euro	1.256	1.371	1.471	1.393	1.30	1.25

[1] Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania.
[2] Real import growth of trading partners weighted by Austrian export shares.

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Projections - June 2010

Private consumption, income and prices

	2006	2007	2008	2009	2010	2011
	Percentage changes from previous year, volume					
Private consumption expenditure	+ 1.8	+ 0.8	+ 0.8	+ 0.4	+ 0.9	+ 0.6
Durables	+ 5.6	+ 3.6	+ 2.2	+ 10.9	– 0.4	– 0.3
Non-durables and services	+ 1.4	+ 0.5	+ 0.6	– 0.7	+ 1.0	+ 0.8
Household disposable income	+ 3.0	+ 1.7	+ 1.7	– 1.1	+ 0.5	+ 0.1
	As a percentage of disposable income					
Household saving ratio[1]	10.8	11.3	12.0	11.0	10.6	10.2
Household saving ratio[2]	10.2	11.0	11.8	10.5	10.2	9.8
	Percentage changes from previous year					
Direct lending to domestic non-banks[3]	+ 4.5	+ 3.6	+ 7.4	– 1.3	+ 1.6	+ 3.7
Inflation rate						
National	1.5	2.2	3.2	0.5	1.8	2.1
Harmonised	1.7	2.2	3.2	0.4	1.8	2.1
Core inflation[4]	1.3	1.9	2.4	1.5	1.3	1.6

[1] Including Adjustment for the change in net equity of households in pension fund reserves.

[2] Excluding Adjustment for the change in net equity of households in pension fund reserves.

[3] End of period.

[4] Excluding unprocessed food (meat, fish, fruits, vegetables) and energy items.

Productivity

Percentage changes from previous year

	2006	2007	2008	2009	2010	2011
Total economy						
Real GDP	+ 3.5	+ 3.5	+ 2.0	– 3.5	+ 1.2	+ 1.6
Employment[1]	+ 1.5	+ 1.7	+ 2.3	– 1.1	+ 0.6	+ 0.7
Productivity (GDP per employment)	+ 2.0	+ 1.8	– 0.2	– 2.4	+ 0.6	+ 0.9
Manufacturing						
Production[2]	+ 9.2	+ 7.5	+ 3.9	– 11.7	+ 3.5	+ 5.8
Employees[3]	+ 0.2	+ 2.6	+ 1.7	– 6.0	– 2.0	– 0.4
Productivity per hour	+ 8.8	+ 5.1	+ 2.7	– 2.5	+ 4.1	+ 5.7
Working hours per day per employee[4]	+ 0.2	– 0.3	– 0.5	– 3.6	+ 1.5	+ 0.5

[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

	2006	2007	2008	2009	2010	2011
Gross earnings per employee[1]	+ 3.2	+ 3.1	+ 2.7	+ 2.3	+ 1.5	+ 1.8
Gross real earnings per employee[1]	+ 1.0	+ 0.5	+ 0.0	+ 1.1	– 0.3	– 0.3
Net real earnings per employee[1]	+ 0.8	+ 0.4	– 0.5	+ 2.3	– 0.5	– 0.5
Total economy						
Unit labour costs	+ 1.0	+ 1.1	+ 2.8	+ 4.9	+ 0.9	+ 0.9
Manufacturing						
Unit labour costs	– 4.2	– 1.7	+ 1.0	+ 9.6	– 2.9	– 3.5
Effective exchange rate - manufactures						
Nominal	+ 0.2	+ 1.2	+ 1.1	+ 0.7	– 0.7	– 0.4
Real	– 0.4	+ 0.8	+ 0.6	+ 0.3	– 0.8	– 0.2

[1] Employees according to National Accounts definition.

Labour market

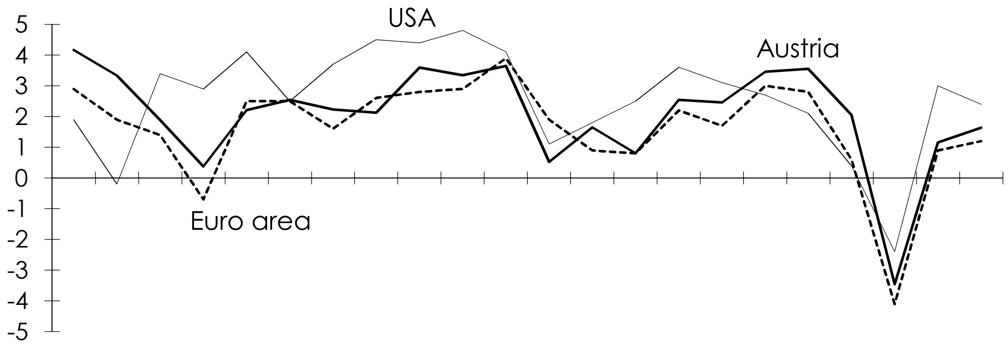
Changes from previous year (1,000[s])

		2006	2007	2008	2009	2010	2011
Demand for labour							
Persons in active employment[1]		+ 56.1	+ 68.6	+ 84.2	– 38.6	+ 20.7	+ 20.8
Employees[2]		+ 51.5	+ 65.5	+ 76.7	– 44.8	+ 15.9	+ 18.0
Percentage changes from previous year		+ 1.7	+ 2.1	+ 2.4	– 1.4	+ 0.5	+ 0.5
Nationals		+ 35.0	+ 43.6	+ 53.2	– 39.2	+ 11.4	+ 12.5
Foreign workers		+ 16.5	+ 21.9	+ 23.5	– 5.6	+ 4.5	+ 5.5
Self-employed[3]		+ 4.6	+ 3.1	+ 7.5	+ 6.2	+ 4.8	+ 2.8
Labour supply							
Population of working age	(15 to 64 years)	+ 12.8	+ 15.5	+ 27.7	+ 17.3	+ 26.3	+ 30.6
	(15 to 59 years)	+ 47.3	+ 17.1	+ 17.6	+ 11.1	+ 12.3	+ 15.9
Labour force[4]		+ 42.6	+ 51.7	+ 74.2	+ 9.4	+ 23.4	+ 26.8
Surplus of labour							
Registered unemployed[5]		– 13.5	– 16.9	– 10.0	+ 48.1	+ 2.7	+ 6.0
	1,000[s]	239.2	222.2	212.3	260.3	263.0	269.0
Unemployed persons in training	1,000[s]	57.5	52.7	50.5	64.1	73.0	70.0
Unemployment rate							
Eurostat definition[6]	percent	4.8	4.4	3.8	4.8	4.9	5.0
Percent of total labour force[5]	percent	6.1	5.6	5.2	6.4	6.5	6.6
National definition[5,7]	percent	6.8	6.2	5.8	7.2	7.2	7.3
Employment rate							
Persons in active employment[1,8]	percent	63.9	64.9	66.1	65.2	65.3	65.3
Total employment (Eurostat)[6,8]	percent	70.2	71.4	72.1	71.6	71.7	71.7

[1] Excluding parental leave and military service. [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).

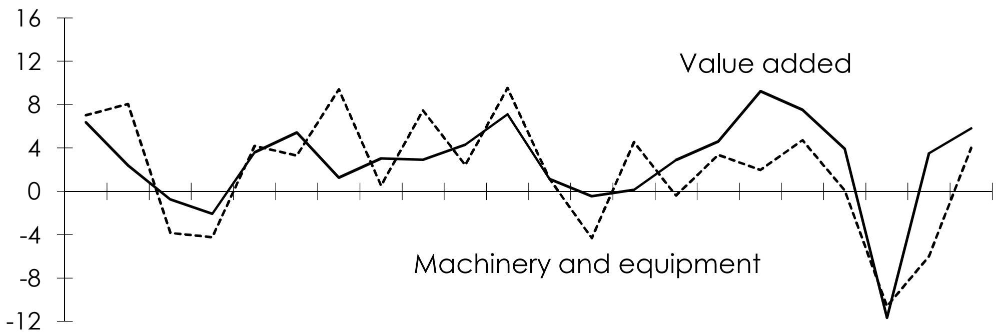
Growth of real GDP

Percent



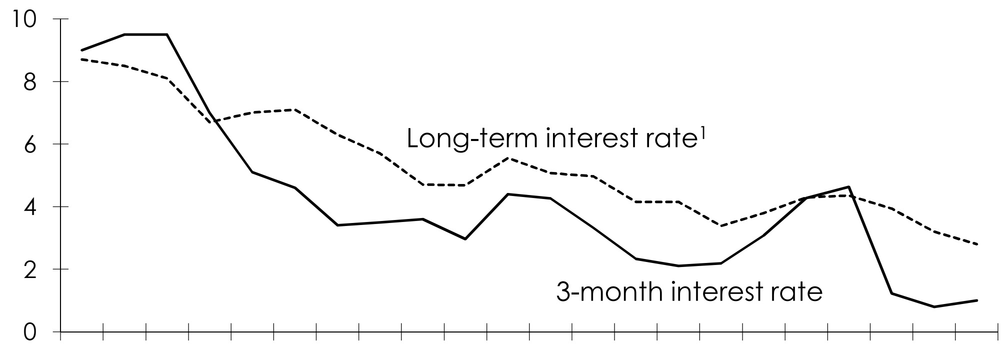
Manufacturing and investment

Percentage changes from previous year, volume



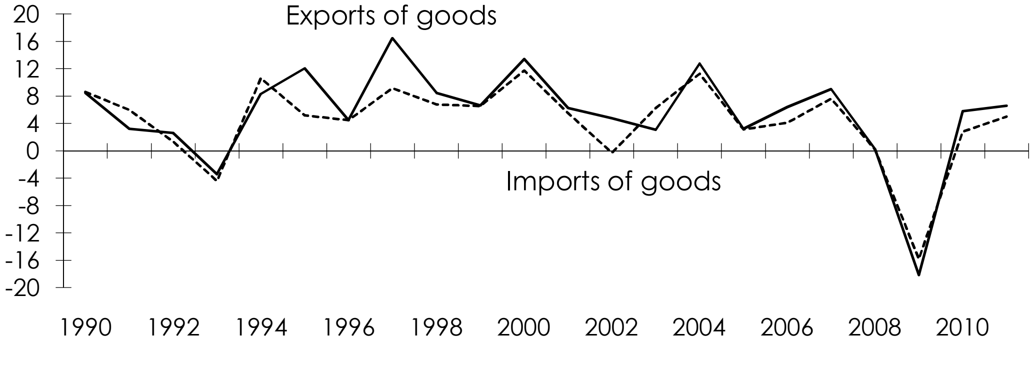
Short-term and long-term interest rates

Percent



Trade

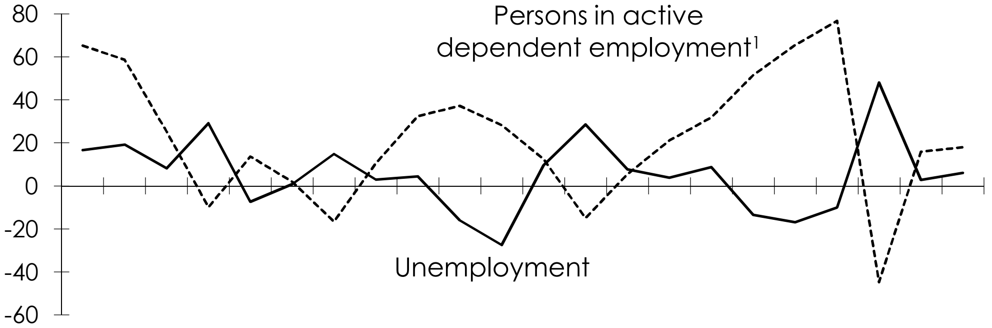
Percentage changes from previous year, volume



[1] 10-year central government bonds (benchmark).

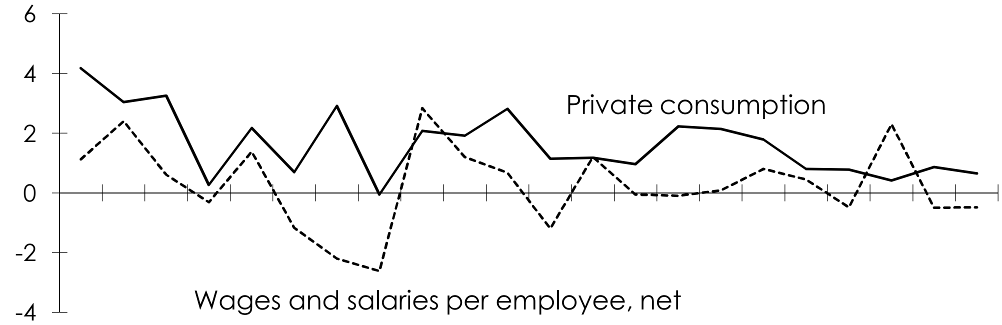
Employment and unemployment

1,000s from previous year



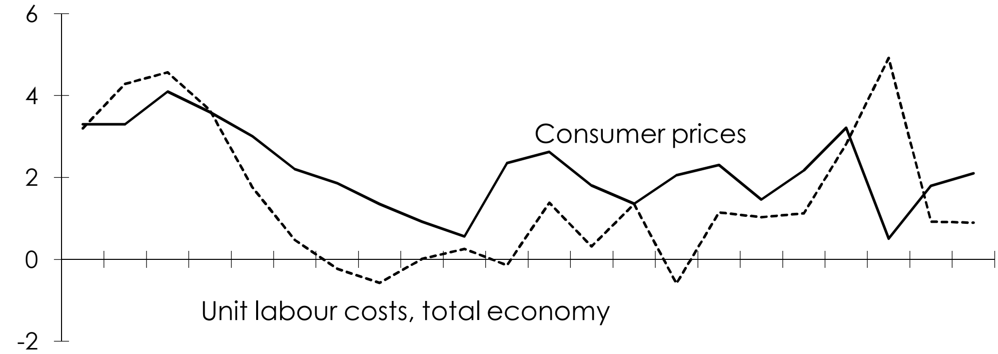
Consumption and income

Percentage changes from previous year, volume



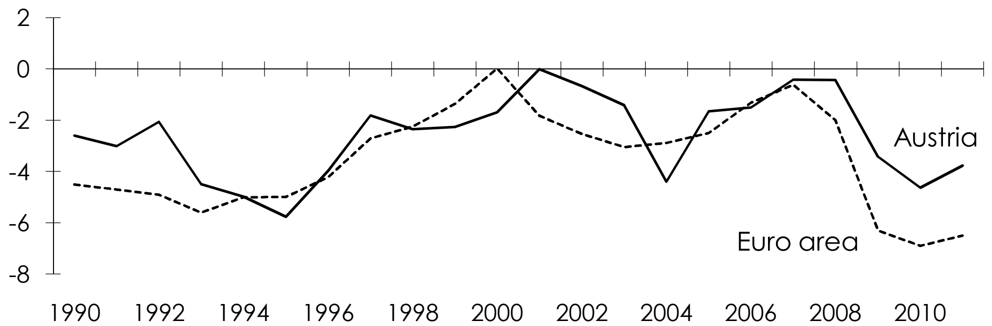
Inflation and unit labour costs

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.