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**Cyclical Upturn Set to Continue,
With Risks Persisting
Economic Outlook for 2011 and 2012**

December 2010

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Austrian Institute of Economic Research

Abstract

The export-driven upswing of economic activity in Austria is expected to continue. Nevertheless, the pace of growth will decelerate markedly in the first half of 2011 as global trade and the expansion in Asia, Latin America and the USA lose momentum; in addition, the planned fiscal consolidation in the euro area and weak competitiveness of the southern European economies will weigh on aggregate demand. Whereas business activity should rebound worldwide in the latter part of 2011 and into 2012, it may remain subdued in the euro area. For Austria, WIFO expects real GDP to expand by 2.2 percent in 2011 and 2.0 percent in 2012. Main driver of demand and output growth are exports, stimulating notably manufacturing and, albeit gradually, business fixed investment. The cyclical revival will help correcting the imbalances on the labour market and in public finances. Yet, at barely below 7 percent of the dependent labour force, unemployment will remain high. The government deficit is likely to narrow to 3.1 percent and 2.7 percent of GDP in 2011 and 2012, respectively.

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Cyclical Upturn Set to Continue, With Risks Persisting

Economic Outlook for 2011 and 2012

The export-driven upswing of economic activity in Austria is expected to continue. Nevertheless, the pace of growth will decelerate markedly in the first half of 2011 as global trade and the expansion in Asia, Latin America and the USA lose momentum; in addition, the planned fiscal consolidation in the euro area and weak competitiveness of the southern European economies will weigh on aggregate demand. Whereas business activity should rebound worldwide in the latter part of 2011 and into 2012, it may remain subdued in the euro area. For Austria, WIFO expects real GDP to expand by 2.2 percent in 2011 and 2.0 percent in 2012. Main driver of demand and output growth are exports, stimulating notably manufacturing and, albeit gradually, business fixed investment. The cyclical revival will help correcting the imbalances on the labour market and in public finances. Yet, at barely below 7 percent of the dependent labour force, unemployment will remain high. The government deficit is likely to narrow to 3.1 percent and 2.7 percent of GDP in 2011 and 2012, respectively.

Growth of world trade and global industrial output eased significantly during 2010. Particularly in Asia, hitherto the engine of the recovery of the world economy, the expansion has shifted into lower gear since the beginning of the year. One reason is that the repletion of inventories after the crisis has largely run its course, another are the moves of China and other emerging economies to preempt cyclical overheating and reduce the growth momentum somewhat. Still, the economies in Asia and Latin America will remain buoyant in 2011 and 2012 and thereby provide strong incentives to global business activity.

In the USA, GDP remains on a moderate upward trend, with exports and industrial output upward bound. Private consumption has proved surprisingly resilient, given the difficult situation on the labour market and reduced prospects for real estate and construction. In the next few years, growth is unlikely to return to pre-crisis rates. Private households will want to reduce their accumulated debt burden, keeping the

saving ratio high and implying restraint on consumption spending and house purchases.

The euro area looks set for a two-speed recovery: Germany and other economies with close ties to Europe's largest economy benefit from the global cyclical upswing and will continue to enjoy healthy growth. In southern Europe and Ireland, on the other hand, severe measures of fiscal restraint and low competitiveness weigh on the return to growth, which will hold back the recovery of the euro area at large. Thus, in the years to come, the expansion will clearly lag behind the rest of the world. In the East-Central European EU countries, however, business activity should regain momentum.

Driven by the strong cyclical revival abroad, notably in Germany, the Austrian economy expanded markedly in the course of 2010. In the third quarter, GDP rose by 0.9 percent in volume from the previous period. The main support came from lively exports which stimulated in particular manufacturing output. Only gradually is the upswing spilling over to corporate investment in machinery and equipment. For the next few months, economic activity can be expected to follow an unabated upward trend; by mid-2011, however, it is likely to slacken in line with developments abroad. The slowdown of world trade growth and fiscal restraint in the euro area will dampen the pace of exports and of the cyclical recovery altogether. Although investment in machinery and equipment should pick up, the slower progress of the recovery will prevent its reinforcement to a boom. In the second half of 2011, growth should regain momentum and further accelerate in 2012. Due to the strong carry-over from 2010, the annual GDP growth rate will, however, be higher for 2011 than for 2012¹. GDP growth for the whole of 2010 is expected at 2.0 percent, the WIFO projection for 2011 and 2012 is for rates of 2.2 percent and 2.0 percent, respectively.

¹) The growth carry-over denotes the impact of the growth profile within a given year on the annual growth rate of the following year. In 2010, the strong GDP growth in the second and third quarter yields a substantial contribution for 2011. The projected annual growth rate of 2.2 percent can thus be attained even with moderate quarter-on-quarter gains. For 2012, on the other hand, the smaller carry-over from 2011 dampens the annual growth rate despite the projected acceleration in the quarterly rates.

The construction industry remains caught in the crisis, with activity barely picking up over the projection period. Private household consumption acted as a stabilising factor during the economic crisis and is set to follow an upward trend until the forecast horizon, although showing a slower momentum than economic activity overall. The main reason is moderate growth of private incomes, set to pick up only by 2012. The slow pace of private consumption will be mirrored by sluggish trade volume growth in 2011 and 2012.

The moderate pace of GDP growth will also be reflected on the labour market. Employment, though steadily heading up, will lose momentum. With labour supply rising further at the same time, unemployment is unlikely to fall from present levels. The jobless rate for 2012 is projected at 6.9 percent on national definitions, equivalent to 4.5 percent in Eurostat terms.

The rate of inflation (CPI) will edge up to 1.8 percent in 2010 and 2.1 percent in 2011, driven by higher energy prices and several indirect tax hikes. Core inflation, however, will increase only little, given the weak upward pressure from unit labour cost. By 2012, the impact of rising energy and food prices will fade, as will the one-off effect of higher indirect taxes. Headline inflation should therefore abate to 1.8 percent.

Thanks to the swift cyclical recovery, the general government deficit for 2010 will turn out at 4.1 percent of GDP, lower than notified last autumn by the Ministry of Finance. The consolidation measures recently adopted should reduce the deficit ratio to 3.1 percent in 2011 and further to 2.7 percent in 2012.

The present forecast is subject to a number of risks: should the recent rise in government bond yields observed in a number of euro area countries continue, the difficulties in these countries' public finances could exacerbate, requiring even more drastic expenditure cuts. This in turn may dampen further aggregate demand in the euro area and jeopardise the stability of Economic and Monetary Union. A further risk surrounds the sluggish recovery in the USA. If financial conditions for private households and government authorities were to deteriorate, this could undermine overall demand and further delay the return to the medium-term growth path.

Vienna, 17 December 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, reference is made to "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.

Carry-over (in economic growth)

The carry-over identifies the impact of the dynamics of a series (in seasonally adjusted figures) during one year (t_0) on the annual percentage change in the following year (t_1). It is defined as the annual percentage change in year t_1 , if GDP in t_1 remains constant at the level of the fourth quarter of year t_0 (in seasonally adjusted terms).

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.

Production Sector

This term comprises the NACE-2008 sections B, C and D (Mining and Quarrying, Manufacturing, Energy Supply) and is here used in an international comparison.

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.ikt.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 - December 2010

Main results

Percentage changes from previous year

		2007	2008	2009	2010	2011	2012
GDP							
Volume		+ 3.7	+ 2.2	- 3.9	+ 2.0	+ 2.2	+ 2.0
Value		+ 5.9	+ 4.1	- 3.1	+ 3.2	+ 3.8	+ 3.8
Manufacturing¹, volume		+ 8.5	+ 3.5	- 14.0	+ 7.0	+ 6.5	+ 5.5
Wholesale and retail trade, volume		+ 2.0	+ 0.9	- 1.4	+ 2.8	+ 1.0	+ 1.0
Private consumption expenditure, volume		+ 0.7	+ 0.5	+ 1.3	+ 1.1	+ 0.9	+ 1.1
Gross fixed investment, volume		+ 3.9	+ 4.1	- 8.8	- 3.1	+ 2.5	+ 2.3
Machinery and equipment		+ 6.6	+ 7.5	- 14.5	- 2.0	+ 4.5	+ 4.0
Construction		+ 1.6	+ 1.6	- 6.0	- 4.0	+ 0.7	+ 0.8
Exports of goods²							
Volume		+ 9.0	+ 0.3	- 18.7	+ 12.3	+ 8.3	+ 8.0
Value		+ 10.5	+ 2.5	- 20.2	+ 16.0	+ 10.5	+ 9.1
Imports of goods²							
Volume		+ 7.6	+ 0.2	- 15.1	+ 9.8	+ 6.5	+ 6.5
Value		+ 9.6	+ 4.7	- 18.4	+ 14.6	+ 9.7	+ 8.1
Current balance	€ bn	+ 9.62	+ 13.76	+ 7.98	+ 10.54	+ 12.34	+ 14.15
	as a percentage of GDP	+ 3.5	+ 4.9	+ 2.9	+ 3.7	+ 4.2	+ 4.6
Long-term interest rate³	percent	4.3	4.4	3.9	3.2	3.0	3.1
Consumer prices		+ 2.2	+ 3.2	+ 0.5	+ 1.8	+ 2.1	+ 1.8
Unemployment rate							
Eurostat definition ⁴	percent	4.4	3.8	4.8	4.5	4.4	4.5
National definition ⁵	percent	6.2	5.8	7.2	6.9	6.8	6.9
Persons in active dependent employment⁶		+ 2.1	+ 2.4	- 1.4	+ 1.0	+ 0.6	+ 0.5
General government financial balance							
according to Maastricht definition							
as a percentage of GDP		- 0.4	- 0.5	- 3.5	- 4.1	- 3.1	- 2.7

¹ Value added, including mining and quarrying. ² According to Statistics Austria. ³ 10-year central government bonds (benchmark). ⁴ According to Eurostat Labour Force Survey. ⁵ Public Employment Service Austria, percent of total labour force excluding self employed. ⁶ Excluding parental leave and military service.

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Key policy indicators

	2007	2008	2009	2010	2011	2012
Fiscal policy						
	As a percentage of GDP					
General government financial balance						
according to Maastricht definition	- 0.4	- 0.5	- 3.5	- 4.1	- 3.1	- 2.7
according to National accounts	- 0.6	- 0.5	- 3.5	- 4.1	- 3.1	- 2.7
General government primary balance	+ 2.3	+ 2.1	- 0.8	- 1.4	- 0.4	+ 0.1
Monetary policy						
	Percent					
3-month interest rate	4.3	4.6	1.2	0.8	1.0	1.5
Long-term interest rate ¹	4.3	4.4	3.9	3.2	3.0	3.1
	Percentage changes from previous year					
Effective exchange rate						
Nominal	+ 1.1	+ 1.2	+ 0.9	- 2.5	- 1.2	- 0.6
Real	+ 0.7	+ 0.6	+ 0.4	- 2.5	- 1.0	- 0.8

¹ 10-year central government bonds (benchmark).

WIFO
Projections - December 2010

World economy

Percentage changes from previous year

	2007	2008	2009	2010	2011	2012
Real GDP						
World	+ 5.3	+ 2.8	- 0.6	+ 4.5	+ 4.1	+ 4.6
USA	+ 1.9	± 0.0	- 2.6	+ 2.7	+ 2.2	+ 2.9
Japan	+ 2.4	- 1.2	- 5.2	+ 3.6	+ 1.6	+ 2.0
EU 27	+ 3.0	+ 0.5	- 4.2	+ 1.8	+ 1.7	+ 1.8
Euro area 16	+ 2.8	+ 0.5	- 4.1	+ 1.7	+ 1.5	+ 1.5
Germany	+ 2.7	+ 1.0	- 4.7	+ 3.6	+ 2.4	+ 2.0
New member states ¹	+ 5.9	+ 3.9	- 3.3	+ 1.9	+ 2.6	+ 3.6
China	+ 14.2	+ 9.6	+ 9.1	+ 10.5	+ 9.0	+ 9.0
World trade , volume	+ 7.1	+ 2.2	- 12.8	+ 16.0	+ 10.0	+ 10.0
Market growth ²	+ 7.1	+ 3.3	- 13.0	+ 12.3	+ 7.8	+ 7.8
Primary commodity prices						
HWI Index, total	+ 3.7	+ 22.4	- 29.2	+ 35	+ 21	+ 13
Excluding energy	+ 9.5	+ 15.6	- 22.7	+ 39	+ 22	+ 19
Crude oil prices						
Brent, USD per barrel	72.5	97.0	61.5	79	90	95
Exchange rate						
USD per euro	1.371	1.471	1.393	1.33	1.25	1.20

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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Private consumption, income and prices

	2007	2008	2009	2010	2011	2012
Percentage changes from previous year, volume						
Private consumption expenditure	+ 0.7	+ 0.5	+ 1.3	+ 1.1	+ 0.9	+ 1.1
Durables	+ 2.6	+ 1.7	+ 5.2	- 1.0	- 0.8	+ 0.8
Non-durables and services	+ 0.5	+ 0.3	+ 1.0	+ 1.3	+ 1.1	+ 1.1
Household disposable income	+ 2.3	+ 0.9	- 0.0	+ 0.8	+ 0.4	+ 1.0
As a percentage of disposable income						
Household saving ratio¹	11.6	11.8	11.1	10.6	10.2	10.0
Household saving ratio²	11.2	11.6	10.4	10.2	9.7	9.6
Percentage changes from previous year						
Direct lending to domestic non-banks³	+ 3.6	+ 7.4	- 1.3	+ 2.5	+ 4.0	+ 4.8
Inflation rate						
National	2.2	3.2	0.5	1.8	2.1	1.8
Harmonised	2.2	3.2	0.4	1.8	2.1	1.9
Core inflation ⁴	1.9	2.4	1.5	1.3	1.6	1.7

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.

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Projections - December 2010

Productivity

Percentage changes from previous year

	2007	2008	2009	2010	2011	2012
Total economy						
Real GDP	+ 3.7	+ 2.2	- 3.9	+ 2.0	+ 2.2	+ 2.0
Employment ¹	+ 1.7	+ 2.2	- 0.8	+ 1.0	+ 0.7	+ 0.5
Productivity (GDP per employment)	+ 2.0	- 0.0	- 3.1	+ 1.0	+ 1.5	+ 1.5
Manufacturing						
Production ²	+ 8.7	+ 3.5	- 14.3	+ 7.0	+ 6.5	+ 5.5
Employees ³	+ 2.6	+ 1.7	- 6.0	- 1.3	+ 0.7	- 0.8
Productivity per hour	+ 6.3	+ 2.3	- 5.4	+ 4.7	+ 5.4	+ 6.4
Working hours per day per employee ⁴	- 0.3	- 0.5	- 3.6	+ 3.5	+ 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.

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Projections - December 2010

Earnings and international competitiveness

Percentage changes from previous year

	2007	2008	2009	2010	2011	2012
Wages and salaries per employee¹						
Gross earnings	+ 3.1	+ 2.9	+ 1.5	+ 1.4	+ 2.0	+ 2.3
Gross real earnings²	+ 0.9	- 0.3	+ 1.0	- 0.4	- 0.1	+ 0.5
Net real earnings²	+ 0.9	- 0.9	+ 2.7	- 0.7	- 0.4	+ 0.2
<i>Total economy</i>						
Unit labour costs	+ 0.9	+ 2.7	+ 4.8	+ 0.6	+ 0.5	+ 0.8
<i>Manufacturing</i>						
Unit labour costs	- 2.3	+ 1.1	+ 13.5	- 5.0	- 3.1	- 3.2
Effective exchange rate - manufactures						
Nominal	+ 1.2	+ 1.1	+ 0.7	- 2.5	- 1.2	- 0.6
Real	+ 0.8	+ 0.6	+ 0.4	- 2.5	- 1.0	- 0.8

¹ Employees according to National Accounts definition.

² Deflated by CPI.

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Projections - December 2010

Labour market

Changes from previous year (1,000^s)

		2007	2008	2009	2010	2011	2012
Demand for labour							
Persons in active employment ¹		+ 68.6	+ 84.2	- 40.6	+ 38.0	+ 27.2	+ 23.5
Employees ²		+ 65.5	+ 76.7	- 46.8	+ 31.3	+ 21.2	+ 18.0
<i>Percentage changes from previous year</i>		+ 2.1	+ 2.4	- 1.4	+ 1.0	+ 0.6	+ 0.5
Nationals		+ 43.6	+ 53.2	- 41.2	+ 14.4	+ 8.3	+ 8.5
Foreign workers		+ 21.9	+ 23.5	- 5.6	+ 16.9	+ 12.9	+ 9.5
Self-employed ³		+ 3.1	+ 7.5	+ 6.2	+ 6.7	+ 6.0	+ 5.5
Labour supply							
Population of working age	(15 to 64 years)	+ 15.5	+ 27.7	+ 17.3	+ 25.7	+ 30.1	+ 16.9
	(15 to 59 years)	+ 17.1	+ 17.6	+ 11.1	+ 12.0	+ 15.5	+ 16.7
Labour force ⁴		+ 51.7	+ 74.2	+ 7.5	+ 28.4	+ 27.2	+ 29.0
Surplus of labour							
Registered unemployed ⁵		- 16.9	- 10.0	+ 48.1	- 9.6	± 0.0	+ 5.5
	1,000 ^s	222.2	212.3	260.3	250.7	250.7	256.2
Unemployed persons in training	1,000 ^s	52.7	50.5	64.1	73.2	67.5	62.5
Unemployment rate							
Eurostat definition ⁶	percent	4.4	3.8	4.8	4.5	4.4	4.5
Percent of total labour force ⁵	percent	5.6	5.2	6.4	6.2	6.1	6.2
National definition ^{5,7}	percent	6.2	5.8	7.2	6.9	6.8	6.9
Employment rate							
Persons in active employment ^{1,8}	percent	64.9	66.1	65.2	65.6	65.7	65.9
Total employment (Eurostat) ^{6,8}	percent	71.4	72.1	71.6	71.8	71.9	71.9

¹ Excluding parental leave and military service. ² According to Federation of Austrian Social Security Institutions.

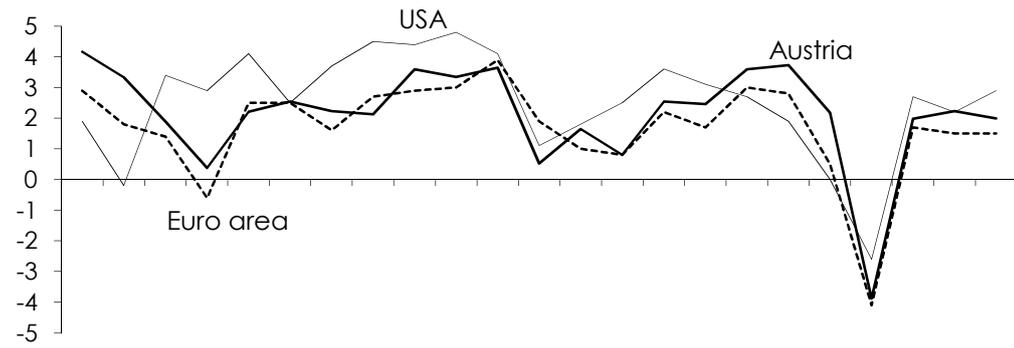
³ According to WIFO. ⁴ Persons in active employment plus unemployment.

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).

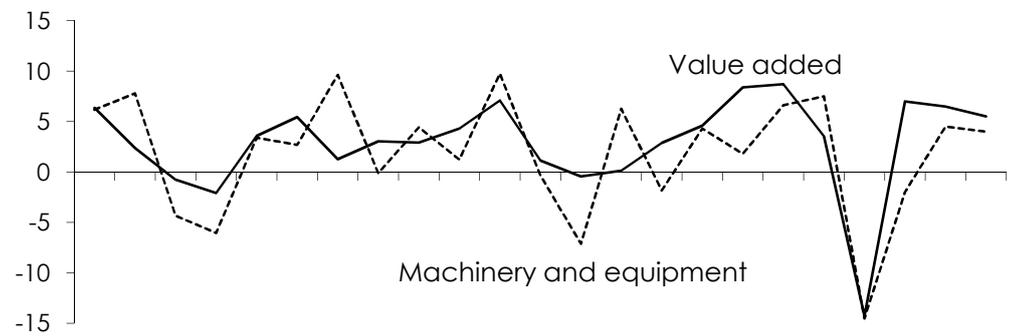
Growth of real GDP

Percent



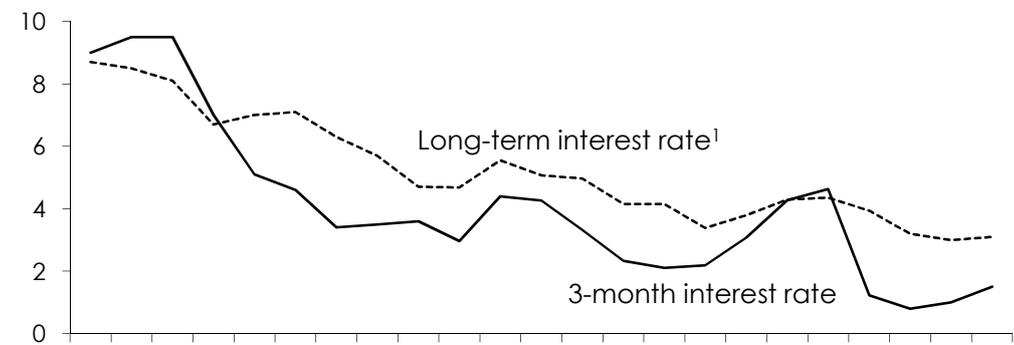
Manufacturing and investment

Percentage changes from previous year, volume



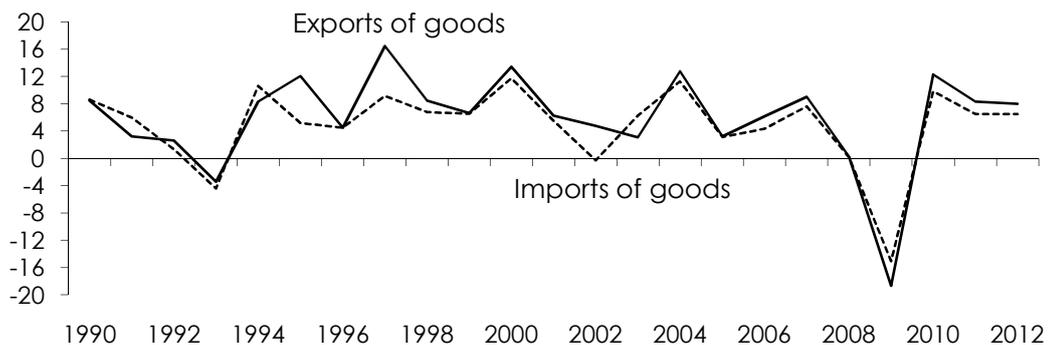
Short-term and long-term interest rates

Percent



Trade

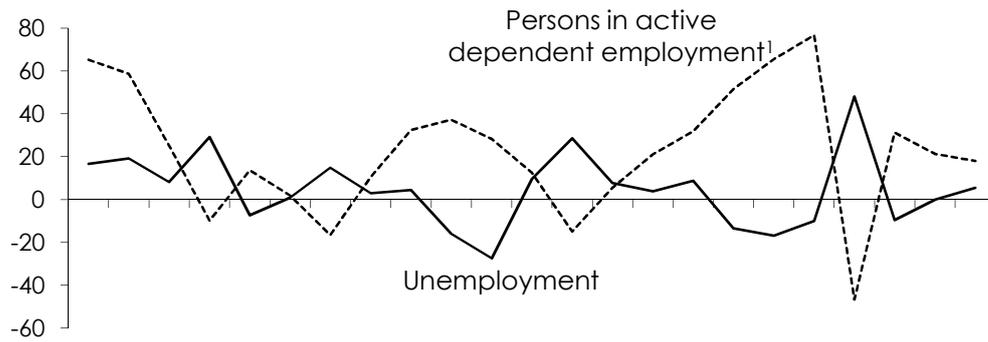
Percentage changes from previous year, volume



¹ 10-year central government bonds (benchmark).

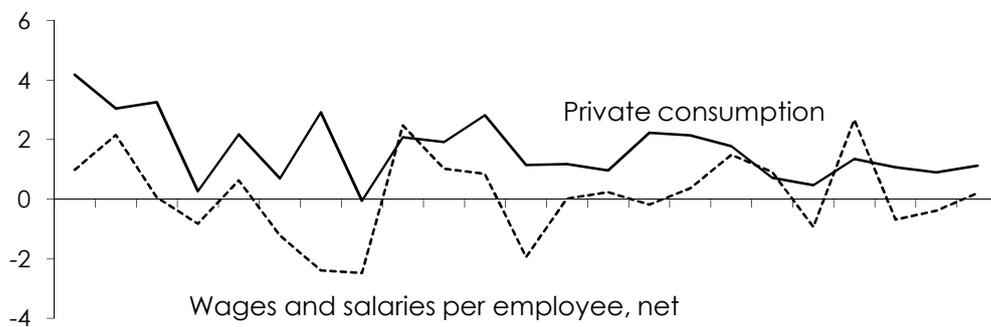
Employment and unemployment

1,000^s from previous year



Consumption and income

Percentage changes from previous year, volume



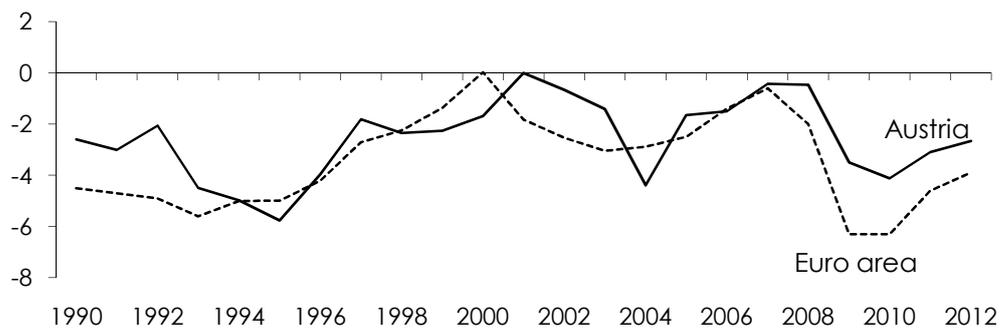
Inflation and unit labour costs

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.