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 **ÖSTERREICHISCHES INSTITUT FÜR
WIRTSCHAFTSFORSCHUNG**

**Sluggish Private Consumption
Holding Back the Pace of Recovery
Economic Outlook for 2014 and 2015**

December 2013

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Economic Outlook for 2014 and 2015

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Austrian Institute of Economic Research

Abstract

Leading indicators are signalling an early revival of business activity in Austria, supported mainly by the catching up of investment so far withheld and by strengthening foreign demand from key destinations like Germany and the USA. Still, the momentum of the recovery remains muted as private consumption is constrained by modest wage gains, fragile labour market conditions and fiscal retrenchment. While inflation is set to ease slightly over the projection period, the rate of unemployment will edge up further in 2014.

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Sluggish Private Consumption Holding Back the Pace of Recovery

Economic Outlook for 2014 and 2015

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In 2013, global economic growth decelerated for the third year in a row. Likewise, the expansion of world trade was lacking momentum, as a rather large part of it is accounted for by the exchange between the crisis-ridden countries of the euro area. With the better business conditions in prospect, trade volumes will pick up (2014 +5.0 percent, 2015 +6.5 percent), and world GDP growth is expected to strengthen gradually to rates of 3.6 percent in 2014 and 4.0 percent in 2015.

Austria's foreign trade is benefitting from a revival in key markets such as Germany, the USA and several countries in East-central Europe. In the regular WIFO Business Cycle Survey, business expectations of domestic firms have turned significantly more optimistic in recent months. The WIFO Leading Indicator points to a gradual recovery of activity, as the improvement on financial markets is extending to the real economy. Yet, the momentum of the recovery remains muted as private consumption is constrained by stagnating net real wages, fragile labour market conditions and fiscal retrenchment. Labour supply is boosted by one-off factors like stricter rules for the access to retirement and the opening of the labour market to workers from Bulgaria and Romania. Since job creation in 2014 will hardly keep pace with the rising labour force, the unemployment rate will edge up to 7.9 percent and remain flat in 2015.

Government finance developments are shaped by one-off factors (auction proceeds, tax agreements with Switzerland and Liechtenstein, capital transfers to banks) and new consolidation measures. The present projections assume tax

increases and expenditure cuts improving the budget balance by some € 2 billion in 2014 and € 1 billion in 2015. The financial gap identified by the "accounts check" would, given its composition, have an only marginal expansionary effect that would have to be set against the restrictive impact of the additional consolidation measures expected. These altogether small effects working in opposite direction are likely to offset each other. Real GDP, having edged up by only 0.3 percent in 2013, is projected to grow by 1.7 percent each in 2014 and 2015.

Business conditions in the euro area have improved recently. Yet, fiscal restriction and low inflation complicate the reduction of private household and corporate debt that in a number of countries is very high and even rising in some. Private sector deleveraging is weighing on household consumption, investment and credit extension. With the upswing gaining ground, the current account deficits of the periphery countries may widen again; the external vulnerability of these countries thus remains a cyclical risk.

By restraining the purchases of bonds, the US Federal Reserve is about to change the course of monetary policy. Given the favourable real economic and financial conditions, business activity is unlikely to be adversely affected by this move. Fiscal consolidation in 2013 dented business activity only to a limited extent, since it largely relied on revenue-raising measures and private household indebtedness had already dropped markedly before. As suggested by the experience of October 2013, the debt ceiling at present covering expenditure overruns until mid-2014 is likely to be raised further in order to accommodate current government refinancing requirements.

While the VAT increase in 2014 will pull the Japanese economy out of deflation, it will at the same time weigh on business activity. A rise in nominal wages is not yet in sight. In Brazil, demand and output growth is constrained by higher import prices and interest rates, in India also by controls on capital mobility. China and Russia are both moving towards a slower path of potential output growth.

Cut-off date: 17 December 2013

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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).

Average rates of change

The time given refers to the initial and the final value of the period of computation: hence the average rate 2005-2010 comprises as the first rate of change that from 2005 to 2006, and as the last that from 2009 to 2010.

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/>).

Core inflation as a monetary policy indicator is not clearly defined. WIFO follows the common practice of using the inflation rate excluding the product categories unprocessed food and energy for core inflation. Thus just under 87 percent of the goods and services contained in the consumer price index (CPI 2010) are included in the calculation of core inflation.

WIFO Business Cycle Survey and WIFO Investment Survey

The WIFO Business Cycle Survey is a monthly survey in which around 1,500 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.konjunkturtest.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 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 2013

Main results

Percentage changes from previous year

	2010	2011	2012	2013	2014	2015
					Forecasts	
GDP						
Volume	+ 1.8	+ 2.8	+ 0.9	+ 0.3	+ 1.7	+ 1.7
Value	+ 3.2	+ 4.9	+ 2.6	+ 2.3	+ 3.5	+ 3.6
Manufacturing¹, volume	+ 7.6	+ 8.3	+ 1.1	+ 0.8	+ 3.5	+ 4.2
Wholesale and retail trade, volume	+ 2.2	+ 1.3	- 1.7	- 1.3	+ 1.3	+ 2.0
Private consumption expenditure, volume	+ 2.0	+ 0.8	+ 0.5	- 0.1	+ 0.9	+ 1.0
Gross fixed investment, volume	- 1.4	+ 8.5	+ 1.6	- 1.4	+ 3.0	+ 2.1
Machinery and equipment	+ 2.1	+ 14.3	+ 2.1	- 3.5	+ 5.0	+ 3.0
Construction	- 3.9	+ 2.5	+ 2.5	+ 0.5	+ 1.2	+ 1.3
Exports of goods²						
Volume	+ 13.6	+ 8.1	+ 0.8	+ 2.5	+ 5.5	+ 6.5
Value	+ 16.7	+ 11.3	+ 1.5	+ 1.8	+ 6.6	+ 7.5
Imports of goods²						
Volume	+ 11.7	+ 8.6	- 1.3	+ 0.4	+ 5.5	+ 6.0
Value	+ 16.5	+ 15.3	+ 0.7	- 0.8	+ 6.3	+ 7.2
Current balance	€ bn					
	+ 9.74	+ 4.90	+ 4.93	+ 9.65	+ 11.16	+ 12.18
as a percentage of GDP	+ 3.4	+ 1.6	+ 1.6	+ 3.1	+ 3.4	+ 3.6
Long-term interest rate³	percent					
	3.2	3.3	2.4	2.0	2.0	2.0
Consumer prices						
	+ 1.9	+ 3.3	+ 2.4	+ 2.0	+ 1.8	+ 1.9
Unemployment rate						
Eurostat definition ⁴	percent					
	4.4	4.2	4.3	4.9	5.2	5.2
National definition ⁵	percent					
	6.9	6.7	7.0	7.6	7.9	7.9
Persons in active dependent employment⁶						
	+ 0.8	+ 1.9	+ 1.4	+ 0.6	+ 0.8	+ 0.8
General government financial balance						
according to Maastricht definition						
as a percentage of GDP	- 4.5	- 2.5	- 2.5	- 1.9	- 2.0	- 1.6

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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Projections - December 2013

World economy

Percentage changes from previous year

	2010	2011	2012	2013	2014	2015
					Forecasts	
Real GDP						
World	+ 5.2	+ 3.9	+ 3.2	+ 2.8	+ 3.6	+ 4.0
USA	+ 2.5	+ 1.8	+ 2.8	+ 1.7	+ 2.5	+ 3.1
Japan	+ 4.7	- 0.5	+ 1.4	+ 1.8	+ 1.9	+ 1.2
EU 28	+ 2.0	+ 1.7	- 0.4	± 0.0	+ 1.4	+ 1.8
Euro area 17	+ 2.0	+ 1.6	- 0.7	- 0.4	+ 1.1	+ 1.4
Germany	+ 4.0	+ 3.3	+ 0.7	+ 0.5	+ 1.7	+ 1.9
New member states ¹	+ 2.2	+ 3.3	+ 0.9	+ 1.3	+ 2.5	+ 3.0
China	+ 10.4	+ 9.3	+ 7.7	+ 7.7	+ 7.9	+ 7.3
World trade, volume	+ 14.6	+ 6.2	+ 2.0	+ 2.5	+ 5.0	+ 6.5
Market growth²	+ 11.9	+ 6.5	+ 1.7	+ 2.3	+ 5.5	+ 6.5
Primary commodity prices³						
HWI Index, total	+ 28.9	+ 28.6	- 2.8	- 4.0	- 2	± 0
Excluding energy	+ 31.9	+ 19.2	- 14.4	- 7.0	+ 1	+ 2
Crude oil prices						
Brent, USD per barrel	79.5	111.3	111.6	108.0	105	105
Exchange rate						
USD per euro	1.327	1.392	1.286	1.320	1.30	1.25

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

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

³ In USD.

Key policy indicators

	2010	2011	2012	2013	2014	2015
	Forecasts					
Fiscal policy						
	As a percentage of GDP					
General government financial balance						
according to Maastricht definition	- 4.5	- 2.5	- 2.5	- 1.9	- 2.0	- 1.6
General government primary balance	- 1.8	+ 0.2	+ 0.1	+ 0.7	+ 0.4	+ 0.8
Monetary policy						
	Percent					
3-month interest rate	0.8	1.4	0.6	0.2	0.2	0.2
Long-term interest rate ¹	3.2	3.3	2.4	2.0	2.0	2.0
	Percentage changes from previous year					
Effective exchange rate						
Nominal	- 2.7	+ 0.2	- 1.5	+ 0.7	+ 0.4	- 0.2
Real	- 3.0	+ 0.6	- 1.6	+ 1.0	+ 0.4	- 0.2

¹ 10-year central government bonds (benchmark).

Productivity

Percentage changes from previous year

	2010	2011	2012	2013	2014	2015
	Forecasts					
Total economy						
Real GDP	+ 1.8	+ 2.8	+ 0.9	+ 0.3	+ 1.7	+ 1.7
Employment ¹	+ 0.7	+ 1.8	+ 1.4	+ 0.6	+ 0.8	+ 0.9
Productivity (GDP per employment)	+ 1.0	+ 1.0	- 0.5	- 0.3	+ 0.8	+ 0.9
 Manufacturing						
Production ²	+ 7.8	+ 8.3	+ 1.2	+ 0.8	+ 3.5	+ 4.2
Employees ³	- 1.3	+ 1.9	+ 1.7	± 0.0	+ 0.1	+ 0.3
Productivity per hour	+ 6.0	+ 6.4	+ 0.1	+ 0.9	+ 3.0	+ 3.9
Working hours per day per employee ⁴	+ 3.0	- 0.1	- 0.6	- 0.1	+ 0.4	± 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 2013

Private consumption, income and prices

	2010	2011	2012	2013	2014	2015
	Forecasts					
	Percentage changes from previous year, volume					
Private consumption expenditure	+ 2.0	+ 0.8	+ 0.5	- 0.1	+ 0.9	+ 1.0
Durables	+ 1.6	+ 1.8	+ 0.6	- 4.8	+ 0.8	+ 1.5
Non-durables and services	+ 2.0	+ 0.7	+ 0.5	+ 0.4	+ 0.9	+ 0.9
Household disposable income	- 0.5	- 1.3	+ 1.1	- 1.3	+ 1.6	+ 1.7
	As a percentage of disposable income					
Household saving ratio¹	8.9	6.7	7.4	6.3	7.0	7.5
Household saving ratio²	8.4	6.4	7.0	5.9	6.5	7.2
	Percentage changes from previous year					
Direct lending to domestic non-banks³	+ 2.9	+ 2.7	+ 0.0	- 0.2	+ 2.3	+ 2.1
Inflation rate						
National	1.9	3.3	2.4	2.0	1.8	1.9
Harmonised	1.7	3.6	2.6	2.1	1.9	1.9
Core inflation ⁴	1.2	2.8	2.3	2.2	1.9	1.8

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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Earnings and international competitiveness

Percentage changes from previous year

	2010	2011	2012	2013	2014	2015
					Forecasts	
Wages and salaries per employee¹						
Gross earnings	+ 0.9	+ 1.8	+ 2.4	+ 1.9	+ 2.1	+ 2.4
Gross real earnings²	- 0.9	- 1.4	- 0.1	- 0.1	+ 0.3	+ 0.5
Net real earnings²	- 1.1	- 1.8	- 1.1	- 0.5	± 0.0	+ 0.1
Unit labour costs						
Total economy	- 0.0	+ 0.8	+ 3.0	+ 2.2	+ 1.3	+ 1.5
Manufacturing	- 6.9	- 3.0	+ 3.0	+ 1.7	- 1.0	- 1.2
Effective exchange rate - manufactures						
Nominal	- 2.9	+ 0.1	- 1.7	+ 0.7	+ 0.4	- 0.1
Real	- 3.2	+ 0.5	- 1.7	+ 1.0	+ 0.5	- 0.2

¹ Employees according to National Accounts definition.

² Deflated by CPI.

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Projections - December 2013

Labour market

Changes from previous year (1,000^s)

		2010	2011	2012	2013	2014	2015
							Forecasts
Demand for labour							
Persons in active employment ¹		+ 37.4	+ 67.3	+ 51.7	+ 29.0	+ 32.5	+ 33.0
Employees ²		+ 25.5	+ 63.3	+ 47.2	+ 20.0	+ 28.0	+ 28.0
Percentage changes from previous year		+ 0.8	+ 1.9	+ 1.4	+ 0.6	+ 0.8	+ 0.8
Nationals		+ 5.8	+ 25.7	+ 9.0	- 10.0	+ 2.0	+ 2.0
Foreign workers		+ 19.7	+ 37.7	+ 38.1	+ 30.0	+ 26.0	+ 26.0
Self-employed ³		+ 11.9	+ 4.0	+ 4.5	+ 9.0	+ 4.5	+ 5.0
Labour supply							
Population of working age	(15 to 64 years)	+ 17.3	+ 31.3	+ 18.0	+ 14.0	+ 5.8	+ 8.1
	(15 to 59 years)	+ 4.9	+ 11.7	+ 22.3	+ 18.0	+ 5.6	+ 1.7
Labour force ⁴		+ 27.9	+ 63.2	+ 65.6	+ 55.0	+ 48.5	+ 35.0
Surplus of labour							
Registered unemployed ⁵		- 9.5	- 4.1	+ 13.9	+ 26.0	+ 16.0	+ 2.0
	1,000 ^s	250.8	246.7	260.6	286.6	302.6	304.6
Unemployed persons in training	1,000 ^s	73.2	63.2	66.6	73.6	77.6	80.6
Unemployment rate							
Eurostat definition ⁶	percent	4.4	4.2	4.3	4.9	5.2	5.2
Percent of total labour force ⁵	percent	6.2	6.0	6.3	6.8	7.1	7.1
National definition ^{5,7}	percent	6.9	6.7	7.0	7.6	7.9	7.9
Employment rate							
Persons in active employment ^{1,8}	percent	65.4	66.2	66.9	67.3	67.8	68.3
Total employment (Eurostat) ^{6,8}	percent	71.7	72.1	72.5	72.3	72.5	72.9

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

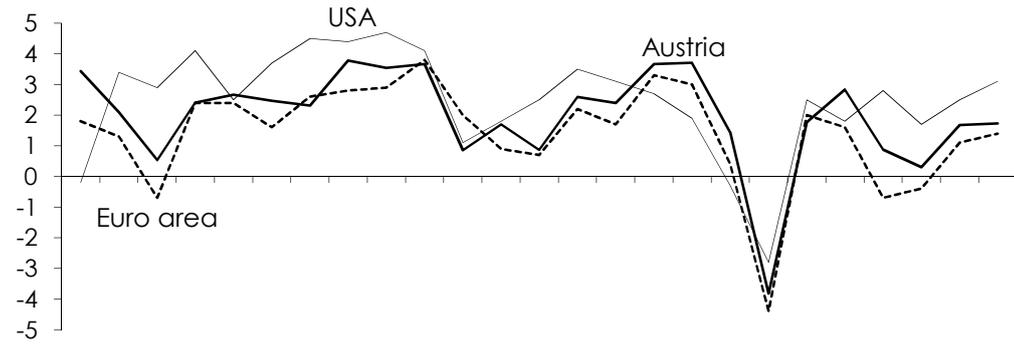
³ According to WIFO. ⁴ Persons in active employment plus unemployment.

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).

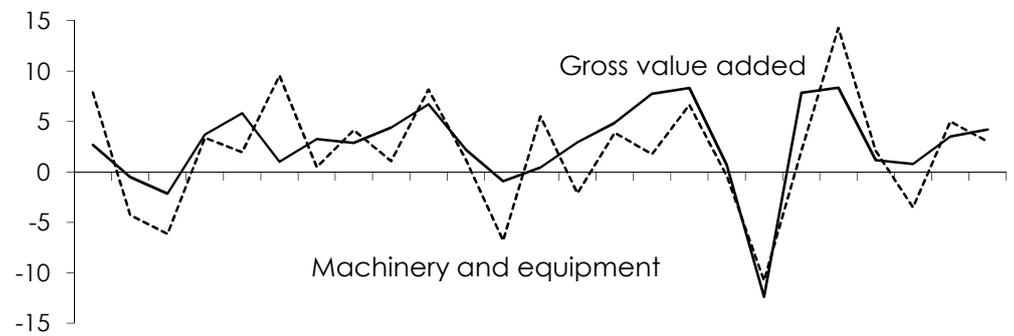
Growth of real GDP

Percent



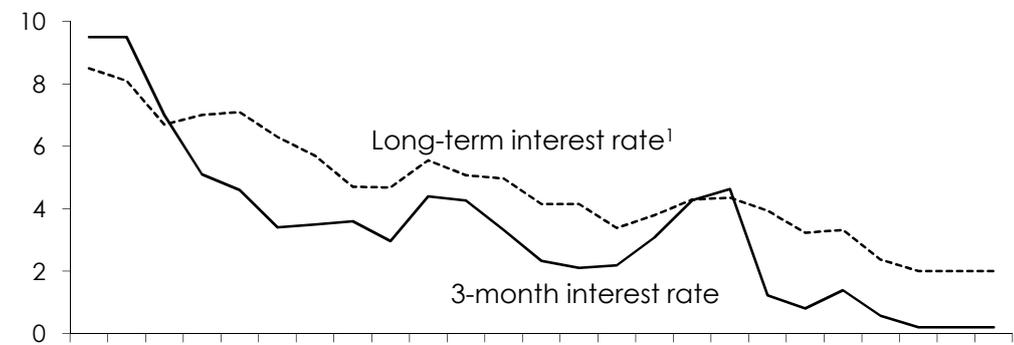
Manufacturing and investment

Percentage changes from previous year, volume



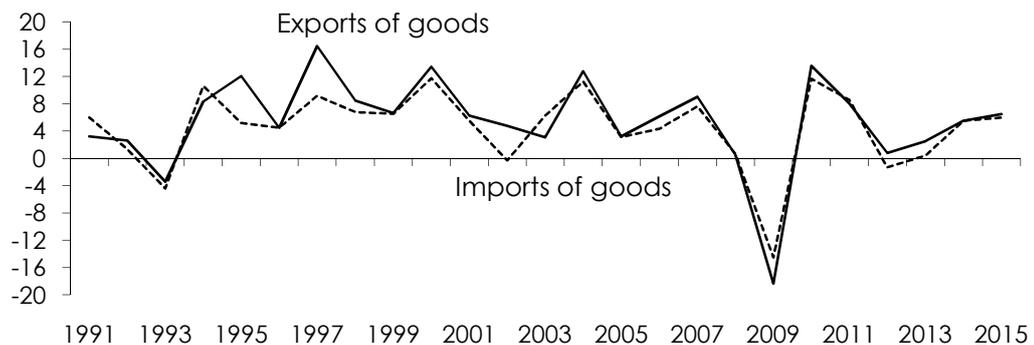
Short-term and long-term interest rates

Percent



Trade

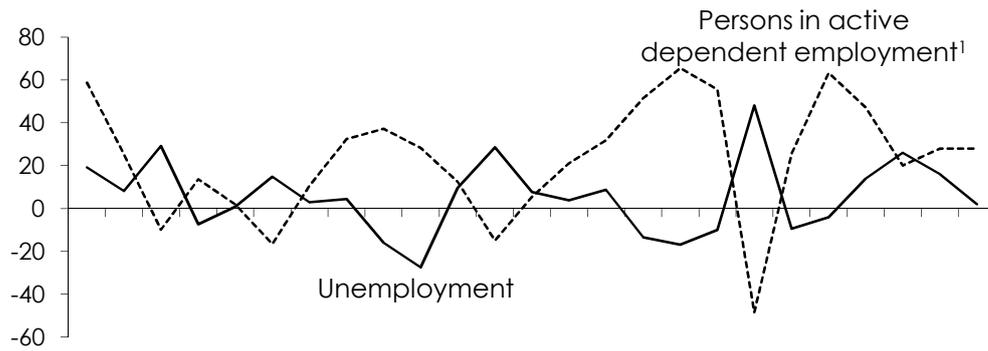
Percentage changes from previous year, volume



¹ 10-year central government bonds (benchmark).

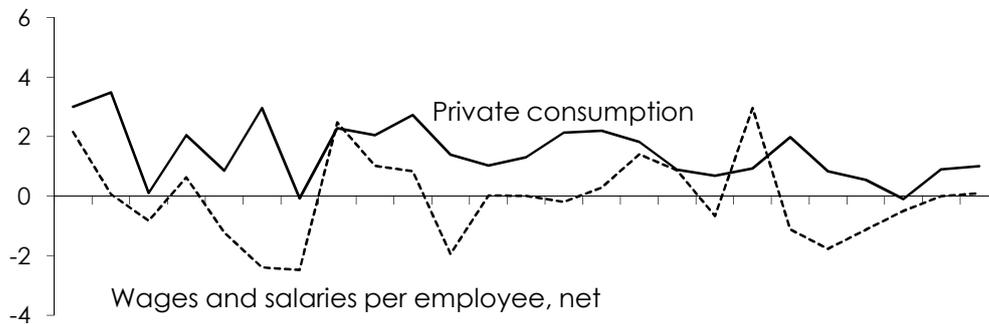
Employment and unemployment

1,000^s from previous year



Consumption and income

Percentage changes from previous year, volume



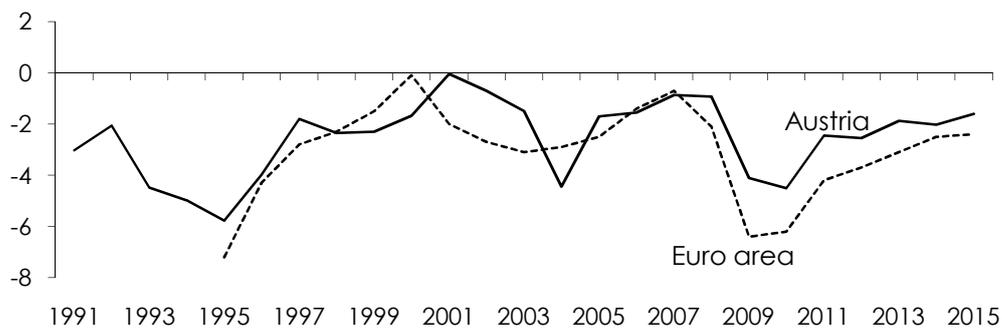
Inflation and unit labour costs

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.