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Exports and Investment Adding Momentum to Cyclical Activity

Economic Outlook for 2006 and 2007

Driven by exports and investment, demand and output in Austria are growing by 2.6 percent in volume in 2006, the highest rate since 2000. By contrast, the momentum of private consumption remains subdued, despite the boost to net incomes from the tax reform. The jump in oil prices is hardly giving rise to second-round effects via wage increases, thereby holding back inflation, but also real income gains. In 2007, the one-off effects from Germany will turn negative, slowing GDP growth in Austria to 2.1 percent.

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For 2006, WIFO expects real GDP to rise by 2.6 percent, an upward revision from the projection of last March by 0.2 percentage points. The more optimistic assessment is motivated by the performance of exports and investment which both have gained momentum this year.

Exports of goods in 2006 are expected to advance by 8 percent in volume, fuelled by strong global activity and a high degree of price competitiveness. In east-central Europe and in Asia, economic growth is somewhat stronger still than expected, and the re-cycling of oil revenues is boosting imports of Russia and the OPEC countries.

The positive sentiment in the business sector is becoming clearly reflected in higher investment plans. According to the latest WIFO investment survey, manufacturers intend to spend 15 percent more than last year on new capital, an increase almost twice as high as that sampled last autumn. Indeed, manufacturing industry, benefiting from strong gains in exports and corporate earnings, is in a particularly favourable situation, whereas investment for the economy as a whole will post a significantly smaller increase. This seems to be confirmed by the rather cautious responses in the investment survey conducted by the Austrian Economic Chamber.

Private consumption has so far not picked up substantially. While employment growth is strengthening private disposable income, real earnings per capita advance at a modest pace. With the household saving ratio broadly unchanged, private consumption will grow by nearly 2 percent in real terms this year.

In 2006, the Austrian economy stands to benefit from purchases in Germany carried forward ahead of the increase in the standard VAT rate. The corresponding negative echo-effect will dampen activity in 2007, suggesting a slowdown in Austrian GDP growth to an annual rate of 2.1 percent.

The cyclical revival this year is raising overall employment by a strong 40,000 or 1.3 percent. Demand for new labour is likely to extend to full-time workers, as suggested by the substantial increase in male jobs and jobs in typical full-time branches like manufacturing and construction. The number of unemployed, down by 11,000 from last year mainly on account of more people being enrolled in job training, should rebound in 2007 as funds for active labour market policy are planned to be cut. The total of jobseekers, including people undergoing training, will stay broadly constant this year and next. Therefore, the cyclical strengthening, while sufficient for

the absorption of the substantial additional labour supply, will not make significant inroads into the existing stock of unemployment.

Headline inflation will remain relatively low, at a projected 1¼ percent in 2006 and 2007. The hike in oil prices has so far had only little inflationary impact: second-round effects via stronger wage increases are reined back by the persistent high unemployment and employees' implicit weak bargaining position. Even for goods and services of high energy intensity, indirect price effects have been limited. A key price-dampening factor is the rise in low-cost imports of manufactures. The rise of China and other transition economies has thus two contradictory effects: on the one hand it is a main driver of higher energy and commodity prices, but it puts downward pressure on import prices of manufactures, on the other.

Table 1: Main results

		2002	2003	2004	2005	2006	2007	
		Percentage changes from previous year						
GDP								
Volume		+ 1.0	+ 1.4	+ 2.4	+ 1.8	+ 2.6	+ 2.1	
Value		+ 2.2	+ 2.8	+ 4.4	+ 3.8	+ 4.4	+ 3.9	
Manufacturing¹, volume								
		+ 0.4	- 0.1	+ 4.6	+ 3.1	+ 5.5	+ 4.5	
Wholesale and retail trade, volume								
		+ 2.0	+ 0.3	+ 1.9	+ 0.4	+ 1.9	+ 2.0	
Private consumption expenditure, volume								
		+ 0.3	+ 1.6	+ 0.8	+ 1.4	+ 1.9	+ 2.0	
Gross fixed investment, volume								
Machinery and equipment ²		- 5.0	+ 6.1	+ 0.6	+ 1.6	+ 3.6	+ 3.3	
Construction		- 8.2	+ 7.7	+ 0.8	+ 1.4	+ 5.0	+ 5.0	
		- 2.3	+ 4.8	+ 0.5	+ 1.8	+ 2.5	+ 2.0	
Exports of goods³								
Volume		+ 4.3	+ 2.6	+12.9	+ 4.0	+ 8.0	+ 5.7	
Value		+ 4.2	+ 1.9	+13.9	+ 5.4	+10.7	+ 6.8	
Imports of goods³								
Volume		+ 0.3	+ 6.5	+11.4	+ 2.9	+ 6.9	+ 6.0	
Value		- 2.0	+ 5.0	+12.5	+ 5.9	+10.5	+ 7.3	
Current balance		billion €	+ 0.75	- 0.48	+ 0.36	+ 3.01	+ 3.02	+ 2.40
As a percentage of GDP			+ 0.3	- 0.2	+ 0.2	+ 1.2	+1.2	+ 0.9
Long-term interest rate⁴		in percent	5.0	4.2	4.2	3.4	4.1	4.3
Consumer prices			+ 1.8	+ 1.3	+ 2.1	+ 2.3	+ 1.7	+ 1.8
Unemployment rate								
Eurostat definition ⁵		in percent	4.2	4.3	4.8	5.2	5.0	5.1
National definition ⁶		in percent	6.9	7.0	7.1	7.3	6.9	7.0
Persons in active dependent employment⁷			- 0.5	+ 0.2	+ 0.7	+ 1.0	+ 1.3	+ 1.1
General government financial balance according to Maastricht definition								
As a percentage of GDP			- 0.5	- 1.5	- 1.1	- 1.5	- 1.7	- 1.3

Source: WIFO Economic Outlook. – 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, as a percentage of total labour force excluding self employed. – ⁷ Excluding parental leave, military service, and unemployed persons in training.

The general government deficit turned out lower in 2005 than expected, mainly due to higher receipts from corporate tax. In the current year, the budget will be burdened by the revenue shortfalls from the 2005 tax reform and its lagged impact on profit taxes. Higher outlays for active labour market policy and research act as additional drag. The general government deficit for 2006 is expected at 1.7 percent of GDP, slightly higher than last year. Since no federal budget draft has yet been submitted for 2007, the assessment of further fiscal developments is necessarily vague. A "package" of measures in support of medium-sized enterprises, worth € 200 million, has been finalised; while it will take effect in 2007, its budgetary impact will largely show up only in the subsequent years. The more favourable business conditions will probably lead to a lower budget deficit in 2007, provided that a restrictive stance is

applied to government spending and the second stage of the administrative reform is implemented without delay.

The world economy will expand by a projected strong 4.6 percent in 2006 and 4.4 percent in 2007, with the USA and Asia remaining the major growth poles. However, the public expenditure restraint necessary to consolidate US government finances and the more restrictive monetary stance will dampen the pace of growth. The large US external imbalance is unlikely to be reduced substantially over the forecast period.

The unabated strong expansion of the Chinese economy continues to shape economic developments in the whole of East Asia. The low exchange rate of the dollar is strengthening China's external competitiveness, apparently offsetting the dampening impact of higher energy prices. The implicit deterioration in the terms of trade helps China to hold back inflationary pressure from abroad even in the face of rising commodity prices. Japan manages to stabilise domestic activity and to keep the export-led recovery on track.

Strong global activity slightly losing steam

The US economy is keeping its strong forward momentum, and Asia also remains on a steep upward trend.

Table 2: World economy

	2002	2003	2004	2005	2006	2007	
	Percentage changes from previous year						
<i>Real GDP</i>							
World total	+ 3.0	+ 4.1	+ 5.1	+ 4.5	+ 4.6	+ 4.4	
Total OECD	+ 1.4	+ 2.0	+ 3.3	+ 2.7	+ 3.0	+ 2.8	
USA	+ 1.6	+ 2.7	+ 4.2	+ 3.5	+ 3.3	+ 3.0	
Japan	+ 0.1	+ 1.8	+ 2.3	+ 2.6	+ 2.8	+ 2.5	
EU 25	+ 1.2	+ 1.2	+ 2.4	+ 1.6	+ 2.2	+ 2.0	
EU 15	+ 1.1	+ 1.0	+ 2.3	+ 1.5	+ 2.1	+ 1.9	
Euro area	+ 0.9	+ 0.7	+ 2.1	+ 1.3	+ 2.1	+ 1.9	
Germany	+ 0.1	- 0.2	+ 1.6	+ 1.0	+ 1.9	+ 1.2	
New member states ¹	+ 2.5	+ 3.9	+ 5.2	+ 4.4	+ 4.7	+ 4.8	
China	+ 9.1	+10.0	+10.1	+ 9.9	+ 9.5	+ 9.0	
<i>World trade, volume</i>	+ 3.5	+ 5.1	+10.0	+ 7.0	+ 8.5	+ 8.0	
<i>Market growth²</i>	+ 2.0	+ 5.6	+ 9.1	+ 6.8	+ 7.8	+ 5.5	
<i>Primary commodity prices</i>							
HWVA index, total	- 5	- 4	+18	+29	+30	+ 2	
Excluding energy	- 6	- 6	+18	+ 6	+20	+ 6	
<i>Crude oil prices</i>							
Average import price (cif) for OECD countries	\$ per barrel	24.1	28.4	36.3	50.3	68.0	68.0
<i>Exchange rate</i>							
\$ per euro		0.945	1.131	1.243	1.245	1.25	1.25

Source: WIFO Economic Outlook. – ¹ Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia. – ² Real import growth of trading partners weighted by Austrian export shares.

The increase in oil prices observed during the last years continues. On the one hand, the speculative price hikes mirror political uncertainties in oil-producing countries; on the other, solid growth of the world economy is driving demand on a sustained basis.

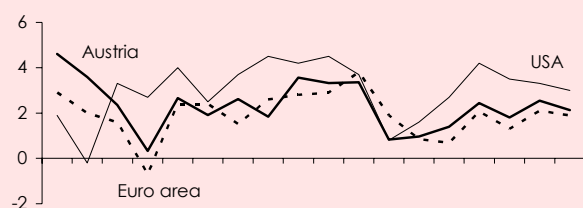
The imponderables of further oil price developments remain a major risk to the forecast, even if the implicit higher revenues of oil producers are fuelling their demand for imported investment and consumer goods. Also, the latest rise in the euro exchange rate vis-à-vis the dollar dampens the impact of the sharp price increases for the euro area. The technical assumption underlying the projections is for an annual average import price for the industrialised countries of € 68 per barrel in 2006, leveling off in 2007.

Oil prices to remain high in 2007

Figure 1: Indicators of economic performance

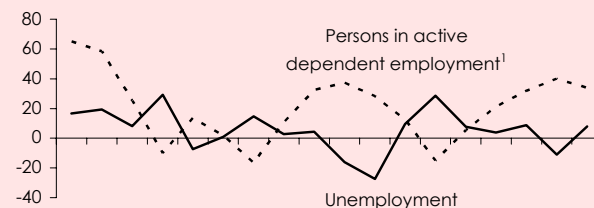
Growth of real GDP

Percent



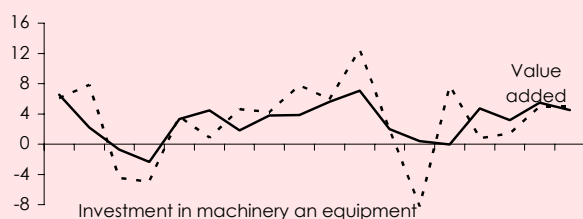
Employment and unemployment

1,000 from previous year



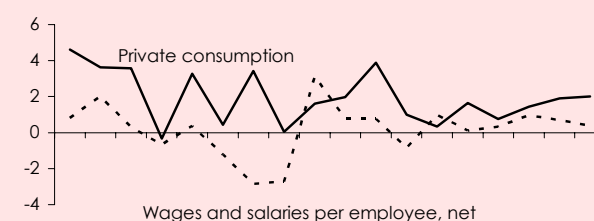
Manufacturing and investment

Percentage changes from previous year, volume



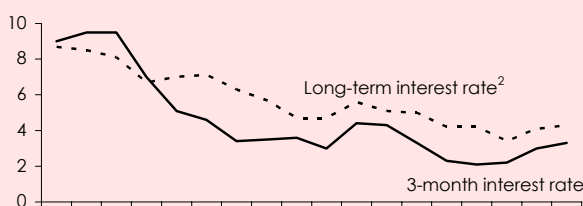
Consumption and income

Percentage changes from previous year, volume



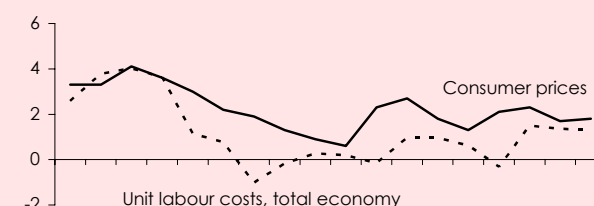
Short-term and long-term interest rates

Percent



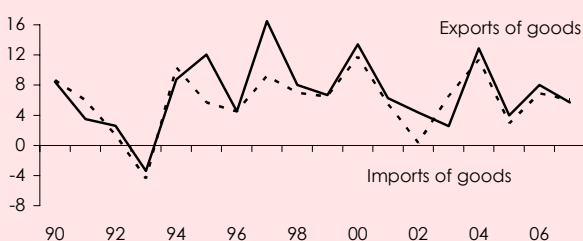
Inflation and unit labour costs

Percentage changes from previous year



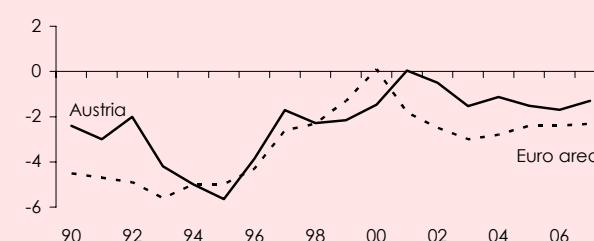
Trade

Percentage changes from previous year, volume



General government financial balance

As a percentage of GDP



Source: WIFO Economic Outlook. – ¹ Excluding parental leave, military service, and unemployed persons in training. – ² 10-year central government bonds (benchmark).

The euro, having markedly depreciated against the dollar in early 2006, rebounded significantly thereafter. On international foreign exchange markets, concerns about the high US current account deficit seem to outweigh the persistent substantial interest rate differential between the two economic areas. WIFO now assumes an exchange rate of \$ 1.25 per euro on annual average 2006, held constant in 2007.

In the first quarter of 2006, GDP rose by 1.3 percent from the previous period, rebounding from the +0.4 percent in the year-end quarter of 2005. Several leading indicators point nevertheless to a deceleration of activity in the remainder of the year: consumer confidence weakened markedly in May, signalling that private household spending may be undermined by the increase in interest rates by the Fed and by the end of the real estate price boom.

The strong pace of growth of the past years has given rise to imbalances that carry considerable risks. The gap in the trade balance is widening steadily, the important general government deficit will lead to fiscal retrenchment, and the private saving ratio has fallen to unusually low levels as a consequence of booming real estate values.

Given the strong result for the first quarter, WIFO expects GDP growth at 3.3 percent for the whole year 2006, edging down to 3 percent in 2007. This projection rests on the assumption that the macro-economic imbalances will unwind only gradually, if at all, whereas a sharp correction would carry major cyclical risks.

Growth of the new EU member states' economies, having slowed down to 4.4 percent in 2005, is expected to rebound to 4.7 percent in 2006 and 4.8 percent in 2007. Best performers are Austria's neighbours and key export markets Hungary, Czech Republic and Slovakia. Poland, the largest country of this group, recorded the slowest expansion in 2005: the rise in policy-controlled interest rates in order to contain the current account deficit slowed domestic demand, while growth was sustained by the external contribution.

GDP growth, after a modest 0.3 percent seasonally adjusted in the fourth quarter 2005 (compared with the previous period), accelerated to 0.6 percent in the first three months of the current year. Business surveys confirm the upward trend and signal a further strengthening in the months to come. The major incentives come from exports (+3.1 percent in volume quarter-on-quarter in early 2006, after +0.7 percent in the fourth quarter 2005) which benefit from the international cyclical boom.

The strong performance raises capacity utilisation in manufacturing in the euro area, warranting expectations for a pick-up in investment. Although the latter is already clearly heading up in some countries, its overall increase in the first quarter 2006 of 0.3 percent from the previous quarter has still been rather small.

Private consumption, edging up by 0.7 percent in the first quarter, provided a substantial contribution to GDP growth. Nevertheless, household spending may remain the key problem in the euro area, since the critical situation on labour markets and sluggish growth of private real disposable income act as severe constraints to higher consumption. Even so, the indicator of consumer confidence has been on a slight upward trend since the middle of 2005.

For the current year, WIFO projects euro area GDP growth at 2.1 percent. In 2007, the slackening of global activity and the VAT increase in Germany may take the rate down to 1.9 percent. Domestic demand should nevertheless keep a moderate upward trend, in spite of rising interest rates.

The ongoing increase in energy prices will keep average headline inflation in the euro area above the benchmark of 2 percent. Against this background and given the clear improvement in cyclical conditions, the ECB is likely to take further steps towards higher interest rates in 2006 and 2007.

With the cyclical recovery, the situation on labour markets should improve. At the same time, stronger growth will allow greater progress to be made towards the consolidation of public finances. The VAT increase in Germany will provide additional support in this regard.

Deceleration in US activity from a high pace

A major risk for the further economic trend in the USA derives from the possibility of an abrupt correction of macro-economic imbalances.

Income gap of new EU member states narrowing

Strong exports and reviving investment stimulating activity in the euro area

Global cyclical strength is stimulating the euro area economy. Investment demand, rather subdued so far, is expected to pick up.

As in the past, the German economy will benefit to a particularly high degree from buoyant global activity. Foreign trade statistics show exports rising at double-digit rates since the beginning of the year and export orders heading up. This is being reflected also in higher industrial output. The continuing decline in relative unit labour costs makes for a sustained improvement in price competitiveness, notably vis-à-vis other euro area countries, since here the cost advantages are not offset by the appreciation of the euro against the dollar.

The strong gains in industrial output heighten the chances of triggering an upswing in investment. The fall in gross fixed capital formation in the first quarter 2006 from the previous period was due to a setback in construction (-3 percent in volume), whereas investment in machinery and equipment rose by a healthy 2.2 percent. Since new claims for owner-occupied housing subsidies could only be made up to the end of 2005, a subsequent increase in building activity may be expected for the rest of this year.

Private consumption contributed substantially to GDP growth in Germany in early 2006. Although framework conditions for a sustained pick-up in coming months remain unfavourable, the increase in VAT as from early 2007 will lead to a front-loading of private household purchases. Retail sales have so far not headed up markedly; still, an imminent upswing in demand for passenger cars seems likely, given the advanced average age of over 8 years of the existing stock.

For 2006, WIFO expects GDP growth in Germany at 1.9 percent. Next year, the slackening of world demand and the more restrictive stance of budgetary policy will likely slow the pace of expansion to a rate of 1.2 percent.

In 2005, activity in Austria expanded by 1.8 percent in real terms. In the first quarter 2006, demand and output strengthened further, with GDP rising by a seasonally adjusted 0.6 percent quarter-on-quarter and by 3 percent year-on-year (biased upwards, however, by 2 additional working days).

Results from the regular WIFO investment survey suggest that firms will translate their high export earnings and increasing capacity utilisation into higher investment. The stagnation in machinery and equipment investment observed over the last two years should thereby come to an end. With export strength spilling over to investment, the overall cyclical recovery will make an important step forward.

In 2006, GDP in Austria is set to grow by 2.6 percent, the highest rate since the boom in 2000. The underlying upward trend is being reinforced by temporary effects: Austria will benefit from the carrying-forward of demand in Germany in view of the VAT increase, notably suppliers to the German car industry should see a jump in new orders. Moreover, hotels and restaurants enjoyed an increase in demand as a result of Austria's turn in holding the EU council presidency in the first semester 2006. However, signs are still few that the recovery will further lead to higher private income and consumption. The latter has been held back for the last couple of years by only modest gains in net real earnings and the upward tendency of the household saving ratio.

Short-term risks to the cyclical recovery derive mainly from the instability on commodity and financial markets. A new jump in oil prices or a slump in stock market values could undermine investors' growing optimism. Moreover, further increases in interest rates in the USA and in Europe may hit real estate prices, residential building and private consumption more than expected, notably in countries like the USA, the UK, Spain and others.

For 2007, WIFO expects the recovery to continue. However, the negative "echo effect" of the advance purchases and the VAT increase in Germany will dampen activity. The Bundesbank estimates the restrictive effect of the fiscal consolidation measures at ¾ percent of German GDP. As a consequence, growth in Austria may decelerate to an annual 2.1 percent in 2007.

Lively foreign trade stimulating activity in Germany

Since the beginning of 2006, German exports have risen at double-digit annual rates. Private consumption will be boosted this year by advance purchases ahead of the VAT increase.

Cyclical upturn in Austria reaching investment

Economic growth in Austria is being sustained not only by exports this year, but also by investment, whereas private consumption will hardly show stronger momentum.

As a consequence of moderate wage increases and high productivity gains, unit labour costs in manufacturing have fallen by 16 percent in the last ten years against the average for Austria's trading partners. Today, the export-oriented sectors are reaping the benefits of this development; the other side of the coin is the rather sluggish growth of consumer demand.

In the first quarter 2006, exports rose at double-digit rates; on annual average, merchandise exports are expected to gain 8 percent in volume. Deliveries to the oil-producing countries (OPEC, CIS), to the USA and Asia expanded particularly strongly, but also those to the EU 25 have rebounded markedly (+15 percent).

Imports also increased significantly, mainly due to higher energy costs and the revival of investment – some 80 percent of demand for machinery and equipment are covered by imports. The trade balance will therefore remain broadly unchanged this year. Data for the current account are at present difficult to interpret, for statistical reasons; they are in the process of being revised.

Exports benefiting from their high price competitiveness

With the cyclical upturn in overall demand, Austrian producers can largely benefit from their high degree of price competitiveness. A further advantage is their strong position in the fast-growing markets of Central and Eastern Europe.

Table 3: Earnings and international competitiveness

	2002	2003	2004	2005	2006	2007
	Percentage changes from previous year					
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	+ 0.4	+ 1.1	+ 0.7
Net real earnings per employee ¹	+ 1.0	+ 0.1	+ 0.3	+ 1.0	+ 0.7	+ 0.4
Total economy						
Unit labour costs	+ 1.0	+ 0.6	- 0.3	+ 1.5	+ 1.4	+ 1.3
Manufacturing						
Unit labour costs	- 0.3	- 0.1	- 3.5	- 1.2	- 2.4	- 2.2
Relative unit labour costs ²						
Vis-à-vis trading partners	- 0.7	+ 2.7	- 0.7	- 0.5	- 1.4	- 1.5
Vis-à-vis Germany	- 1.5	+ 1.5	+ 0.4	+ 2.3	+ 0.1	- 0.2
Effective exchange rate, manufactures						
Nominal	+ 1.2	+ 3.7	+ 1.2	- 0.5	± 0.0	- 0.1
Real	+ 0.8	+ 2.9	+ 1.0	- 0.5	- 0.5	- 0.8

Source: WIFO Economic Outlook. – ¹ Employees according to National Accounts definition. – ² In a common currency; minus sign indicates improvement of competitiveness.

Developments in tourism are shaped by a number of one-off factors. Austria's EU council presidency term has temporarily boosted earnings in the first semester, particularly in Vienna and other large cities. The tourism industry is also counting on additional revenues from the "Mozart year" 2006. Excellent snow conditions gave rise to hopes for a strong result for the past winter season which, however, have not been confirmed by the data. The relatively high net surplus in the tourism services balance is set to widen further in the current year.

Table 4: Productivity

	2002	2003	2004	2005	2006	2007
	Percentage changes from previous year					
Total economy						
Real GDP	+ 1.0	+ 1.4	+ 2.4	+ 1.8	+ 2.6	+ 2.1
Employment ¹	- 0.1	+ 0.1	- 0.0	+ 0.9	+ 1.1	+ 0.9
Productivity (GDP per employment)	+ 1.1	+ 1.3	+ 2.5	+ 0.9	+ 1.4	+ 1.2
Manufacturing						
Production ²	+ 0.4	- 0.0	+ 4.7	+ 3.2	+ 5.5	+ 4.5
Employees ³	- 2.5	- 1.7	- 0.6	- 0.9	- 0.2	- 0.5
Productivity per hour	+ 3.5	+ 1.3	+ 4.5	+ 4.7	+ 5.3	+ 5.0
Working hours per day per employee ⁴	- 0.5	+ 0.3	+ 0.8	- 0.6	+ 0.4	± 0.0

Source: WIFO Economic Outlook. – 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 "Konjunkturehebung" of Statistics Austria.

In the face of higher capacity utilisation and brighter sales prospects, firms are launching new investment projects. Manufacturers envisage stepping up their capital spending by a nominal 15 percent from last year, an increase twice as high as the one reported in the previous survey of last autumn. Investment plans are particularly ambitious in the motor car, steel and machine tool industries as well as for the construction of industrial plants. The manufacturing industry is in a particularly favourable situation, enjoying strong growth of exports and profits.

In the first quarter, equipment investment rose by 6 percent in volume from the year-earlier period, but the seasonally adjusted gain from the previous quarters was only modest. The survey conducted by the Austrian Economic Chamber also indicated a rather cautious approach towards new investment in the economy overall. WIFO projects equipment investment to grow by a steady 5 percent in volume both in 2006 and 2007. The strength of a rebound in investment is a key factor for the cyclical recovery, given its repercussions on income and employment.

Also construction investment is showing signs of revival. From a weak start early in the year, activity has been strengthening since spring. In the regular WIFO business survey, firms judge notably their order stocks positively. The situation is favourable in civil engineering which benefits from an increase in budgetary allocations for infrastructure projects. Commercial and office building is increasing, possibly related to the expansion of machinery and equipment investment. However, there is scarce evidence for a pick-up of new homebuilding which is somewhat surprising in view of the immigration-induced strong population growth.

For 2006, WIFO expects construction output to expand by 2.5 percent in volume, slowing down only marginally in 2007.

In 2005, private household demand, adjusted for inflation, edged up by a moderate 1.4 percent from the previous year. The gains in net incomes on account of the tax reform were partly used for higher saving.

Higher wage settlements, decelerating inflation and a marked increase in employment will all make for a somewhat stronger increase in consumption (by nearly 2 percent) this year.

Significant rebound in investment

Results from the WIFO investment survey suggest that the impulse from the export boom is being transmitted to investment. Construction firms report highly satisfactory order levels.

Subdued growth of private consumption

Growth of private consumption is being shaped by modest gains in employees' real income and a slight increase in the saving ratio.

Table 5: 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	+ 1.9	+ 2.0
Durables	+ 0.3	+ 3.2	+ 0.6	+ 1.7	+ 2.4	+ 2.2
Non-durables and services	+ 0.3	+ 1.5	+ 0.8	+ 1.4	+ 1.8	+ 2.0
Household disposable income	+ 0.7	+ 2.3	+ 1.2	+ 1.9	+ 2.0	+ 2.0
	As a percentage of disposable income					
Household saving ratio	7.7	8.6	9.0	9.3	9.4	9.5
	Percentage changes from previous year					
Direct lending to domestic non-banks ¹	+ 1.2	+ 1.6	+ 5.0	+ 4.7	+ 5.4	+ 5.0
	Percentage changes from previous year					
Inflation rate						
National	1.8	1.3	2.1	2.3	1.7	1.8
Harmonised	1.7	1.3	2.0	2.1	1.9	1.9
Core inflation ²	2.0	1.3	1.6	1.5	1.6	1.9

Source: WIFO Economic Outlook. – ¹ End of period. – ² Excluding unprocessed food (meat, fish, fruits, vegetables) and energy items.

While exports and investment have gained momentum since the beginning of the year, consumption has advanced at a slower pace, with notably car purchases remaining sluggish. Although consumer confidence has improved, this has not yet been translated into higher spending. Apparently, the sentiment indicator is a reflection of the general economic situation rather than of households' readiness to

spend. An increase in the latter would indeed be required in order to stimulate business activity, in particular in 2007.

The projection for 2007 is for consumption to remain on a moderate upward path. The private household saving ratio is likely to remain broadly constant at a relatively high 9.5 percent of disposable income.

Prices for crude oil are projected at \$ 68 per barrel on annual average 2006, exceeding the year-earlier level by one-third. Accordingly, prices of fuels, gas and electricity are drifting up strongly. Secondary effects on prices of other goods and services have, however, been largely absent so far. Manufactures prices are broadly stable, and recent wage settlements have mostly provided for increases barely higher than in the previous rounds. The index of contractual wages shows for the early part of 2006 a year-on-year increase of 2.8 percent. Consumer prices are projected to go up by 1.7 percent on annual average, unit labour costs by only 1.4 percent.

For 2007, headline inflation is expected at a similar rate as for the current year. The technical assumption is for unchanged oil prices, but some limited secondary effects from the price jump of the last years are likely to materialise in a period of benign cyclical conditions.

WIFO expects the number of persons in dependent active employment to rise by 40,000 or 1.3 percent on annual average 2006. The strong increase of male employment suggests that also the number of full-time jobs will rise this year. More jobs are being created in typical full-time branches such as manufacturing (including personnel agencies) and construction. Once again, the most important employment gains are recorded in service branches offering ample opportunities for part-time work, i.e., commercial and industrial services, trade and tourism.

Low inflation, despite jump in oil prices

Headline inflation remains under firm control, since the rise in energy costs does not trigger second-round effects on wages. Indirect price effects on energy-intensive goods and services have also been limited so far.

Increase in full-time employment

Total employment is growing strongly this year, with also the number of full-time jobs going up. With more people enrolled in labour market training, unemployment will be shown to decline in spite of a strongly growing labour supply. Next year, however, with training measures planned to be cut, unemployment should rebound.

Table 6: Labour market

		2002	2003	2004	2005	2006	2007
		Changes from previous year, in 1,000					
<i>Demand for labour</i>							
Persons in active employment ¹		- 11.6	+ 8.5	+ 25.1	+ 37.2	+ 45.5	+ 39.5
Employees ²		- 15.0	+ 5.5	+ 21.1	+ 31.9	+ 40.0	+ 34.0
Percentage changes from previous year		- 0.5	+ 0.2	+ 0.7	+ 1.0	+ 1.3	+ 1.1
Nationals		- 20.1	- 10.4	+ 9.2	+ 20.0	+ 24.0	+ 20.0
Foreign workers		+ 5.1	+ 15.9	+ 11.9	+ 11.9	+ 16.0	+ 14.0
Self-employed ³		+ 3.4	+ 3.0	+ 4.0	+ 5.3	+ 5.5	+ 5.5
<i>Labour supply</i>							
Population of working age	15 to 64 years	+ 42.9	+ 37.7	+ 34.4	+ 15.6	+ 6.1	+ 20.2
	15 to 59 years	+ 13.4	+ 21.2	+ 35.6	+ 48.5	+ 37.7	+ 24.9
Labour force ⁴		+ 17.0	+ 16.1	+ 28.9	+ 45.9	+ 34.5	+ 47.5
<i>Surplus of labour</i>							
Registered unemployed ⁵		+ 28.5	+ 7.7	+ 3.8	+ 8.8	- 11.0	+ 8.0
In 1,000		232.4	240.1	243.9	252.7	241.7	249.7
Percent							
<i>Unemployment rate</i>							
Eurostat definition ⁶		4.2	4.3	4.8	5.2	5.0	5.1
As a percentage of total labour force ⁵		6.2	6.3	6.4	6.5	6.2	6.3
National definition ^{5,7}		6.9	7.0	7.1	7.3	6.9	7.0
<i>Employment rate</i>							
Persons in active employment ^{1,8}		62.5	62.2	62.3	62.8	63.5	64.0
Total employment ^{6,8,9}		-	-	67.8	68.6	68.9	69.2

Source: WIFO Economic Outlook. – 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 As a percentage of total labour force, without self-employed. – ⁸ As a percentage of population of working age (15 to 64 years). – ⁹ Changed survey method.

Likewise, vacancies reported to the labour market service confirm the lively demand for new personnel. Their year-on-year increase is growing steadily, reaching +18 percent in May.

Unemployment is set to decline in 2006, for the first time since 2000. The number of jobseekers (according to the labour market service), estimated at 242,000 on annual average, will be lower by 11,000 than last year. This is to a large extent due to more people being enrolled in training courses, since the total of unemployed plus trainees should stay broadly flat this year and next. The unemployment rate (according to the labour market service) will moderate to 6.9 percent in 2006, but will head up again somewhat in 2007, because of the expected cuts in training courses being offered.

Labour supply will grow by 35,000 persons this year, about half of which are foreign workers. Such hefty increase in labour supply complicates the task of cutting unemployment. Youth unemployment (school leavers and persons leaving or dropping out of apprenticeship) as well as lay-offs of older workers (particularly 50 to 55 year-olds) with hardly any chance of finding a new job, remain severe challenges for the domestic labour market. Youth unemployment in Austria is relatively low in an international comparison, mainly thanks to the dual apprenticeship scheme, even if it has trended upwards in the last few years. In 2006, it has been lowered with the help of labour market policy measures.

In 2005, the general government deficit in the Maastricht definition of 1.5 percent of GDP turned out significantly lower than originally projected. The main reason for the more favourable result is to be found in higher revenues from corporate tax and capital gains tax from dividends, a reflection of the excellent profit situation of domestic firms.

The marked revival of cyclical activity points to an increase in tax revenues in 2006. The general government deficit is likely to amount to 1.7 percent of GDP. Uncertainties surround the high revenues from corporate tax in the first few months of the year, which could to some extent be related to temporary shifts in tax payments.

In 2006, government budgets will be burdened by the revenue shortfalls from the tax reform 2005, which for profit taxes will materialise with a lag. On the expenditure side, additional outlays for "active" labour market policy and research as well as a marked increase in pensions and the wage settlement for public sector employees will take effect.

Budget deficit edging up as a consequence of the tax reform

The repercussions of the tax reform 2005 and additional expenditure for research and labour market policy are likely to raise the general government deficit in 2006 from last year, to a ratio of 1.7 percent of GDP.

Table 7: Key policy indicators

	2002	2003	2004	2005	2006	2007
	As a percentage of GDP					
<i>Fiscal policy</i>						
General government financial balance						
According to Maastricht definition	-0.5	-1.5	-1.1	-1.5	-1.7	-1.3
According to National Accounts	-0.7	-1.7	-1.2	-1.6	-1.8	-1.4
General government primary balance	+2.6	+1.4	+1.7	+1.2	+1.1	+1.4
	Percent					
<i>Monetary policy</i>						
3-month interest rate	3.3	2.3	2.1	2.2	3.0	3.3
Long-term interest rate ¹	5.0	4.2	4.2	3.4	4.1	4.3
	Percentage changes from previous year					
<i>Effective exchange rate</i>						
Nominal	+1.3	+3.8	+1.2	-0.6	±0.0	-0.1
Real	+0.6	+2.8	+0.9	-0.7	-0.7	-0.8

Source: WIFO Economic Outlook. – ¹ 10-year central government bonds (benchmark).

The outlook for the 2007 budget remains vague as long as no federal budget draft is submitted. On the basis of the current macro-economic assumptions, revenues should grow at a satisfactory pace, allowing the general government deficit to narrow to 1¼ to 1½ percent depending on the degree of restriction imposed on ex-

penditure. The present WIFO forecast assumes that the second stage of the administrative reform will be implemented at all levels of government and that the outlays for "active" labour market policy will be cut according to earlier plans. The "SME package" will come into force in 2007, but is expected to weaken the government balance mainly in the following years by about € 200 million.