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Medium-term Economic Growth above 2 percent

Projections for the Austrian Economy until 2010

The Austrian economy is expected to grow by 2.1 percent per year until 2010, exceeding the average rate for the euro area. In the next five years, exports will profit from increased demand from abroad and high competitiveness of domestic producers. Investment in the transportation infrastructure and the expected revival of residential building will boost construction output. Also, private household consumption should gradually pick up from its extended stagnation of the past years. However, the overall expansion is unlikely to be strong enough as to decrease unemployment. Against this background, price and wage increases will remain moderate. With the impact of the 2005 tax reform waning, the general government deficit should steadily decline, provided fiscal authorities maintain a restraint on public expenditure.

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With the economic climate in Europe brightening, economic activity should gain momentum in the course of 2006. After a temporary setback caused by the VAT increase in Germany (2007), demand and output are set to resume a moderate upward trend to the end of the decade. While the major risk lies in further hikes in the price of oil, appreciation of the euro vis-à-vis the US dollar may also slow the pace of growth in Europe in the medium term.

Austria's gross domestic product is projected to increase by an annual average of 2.1 percent between 2006 and 2010. This figure is significantly higher than the 1.5 percent p.a. recorded in the period from 2001 to 2005, in the time when economic activity in Austria was held back by the cyclical weakness in Europe. With activity in Europe expected to gain momentum, Austria's GDP growth rate is expected to return to its long-term trend. The increase in labour supply should be sufficient to accommodate higher growth.

Several factors indicate that Austria's medium-term growth will exceed that of the euro area:

- Austria's price competitiveness, as measured by unit labour costs, will further improve, thereby strengthening Austria's exports.
- Austrian producers profit to a high degree from the latest round of EU enlargement, with Austria being among the key trading partners of these fast-growing economies.
- Germany's weak economic performance in recent years has been weighing on the economic activity in Austria. In the next five years, Germany's economy should be able to reduce its growth lag, boosting Austria's exports to this country.
- Labour supply, notably from abroad, will continue to rise over the next few years. While this will boost activity and employment in sectors facing labour shortages, it will also reduce the prospect of a decline in unemployment.
- The priority given by economic policy to the promotion of research and development should bear fruit in the medium term. In addition, growth in 2006 and 2007 should benefit from the impact of the latest tax reform. Domestic fiscal pol-

icy is providing somewhat stronger growth incentives than policy in those European countries where high deficits exert pressure for consolidation (notably in Germany, France and Italy).

In an environment of world-wide structural adjustment, Austria can only maintain its relatively high living standards if it is ready to reinforce investment in areas such as research and development, education, infrastructure as well as information and communication technologies. It is in these areas where the foundations for an economy's future growth potential are laid.

According to the present medium-term projections, growth of Austria's GDP of 2.1 percent p.a. in volume is set to exceed the average for both the EU 15 (+2.0 percent) and the euro area (+1.8 percent).

Table 1: Main results

	Ø 1995-2000	Ø 2000-2005	Ø 2005-2010	2005	2006	2007	2008	2009	2010
	Year-to-year percentage changes								
Gross domestic product									
Volume	+ 2.9	+ 1.5	+ 2.1	+ 1.9	+ 2.4	+ 2.0	+ 1.9	+ 2.2	+ 2.1
Value	+ 3.7	+ 3.2	+ 4.1	+ 4.0	+ 4.3	+ 4.0	+ 3.8	+ 4.1	+ 4.0
Consumer prices	+ 1.4	+ 2.0	+ 1.9	+ 2.3	+ 1.7	+ 1.9	+ 1.9	+ 2.0	+ 2.0
Gross wages and salaries per employee ¹	+ 1.8	+ 2.0	+ 2.6	+ 2.4	+ 2.8	+ 2.5	+ 2.5	+ 2.7	+ 2.7
Active dependent employment ²	+ 0.6	+ 0.4	+ 0.9	+ 1.0	+ 1.1	+ 0.9	+ 0.7	+ 0.8	+ 0.9
	Ø 1996-2000	Ø 2001-2005	Ø 2006-2010	2005	2006	2007	2008	2009	2010
	In percent								
Unemployment rate									
Eurostat definition ³	.	.	5.3	5.2	5.2	5.2	5.3	5.3	5.4
National definition ⁴	6.8	6.9	7.3	7.2	7.1	7.2	7.3	7.3	7.4
	As a percentage of GDP								
Net exports	0.8	4.2	6.0	5.3	5.7	5.8	5.9	6.1	6.3
General government financial balance (Maastricht definition)	- 2.3	- 0.9	- 1.2	- 1.5	- 1.9	- 1.5	- 1.3	- 0.9	- 0.5
	As a percentage of disposable income								
Household saving ratio	8.2	8.4	9.3	9.5	9.6	9.5	9.3	9.2	9.0

Source: Statistics Austria, WIFO calculations. – ¹ Excl. employers' contributions, employees according to National Accounts definition. – ² Excluding parental leave, military service, and unemployed persons in training. – ³ According Eurostat Labour Force Survey. – ⁴ According to Labour Market Service, percent of total labour force excluding self-employed.

Nevertheless, the projected pace of growth will not result in a substantial fall in the rate of unemployment because of a market increase in domestic and foreign labour supply. Although employment is expected to gain a healthy 0.9 percent p.a., the jobless rate is likely to stay high, i.e., at 5.4 percent according to Eurostat or 7.4 percent according to the national definition.

The excess supply of labour and the low degree of utilisation of productive capacities will continue to put a lid on wage and price increases. For oil and energy prices, the projections assume a moderate upward trend. Headline inflation should therefore remain below the mark of 2 percent over the projection period.

Medium-term developments in public finances are difficult to foresee, given that no government budgets have yet been submitted for future years and the Austrian Stability Programme extends to 2008 only. Under plausible assumptions for government expenditure, the flow of revenues as determined largely by growth of nominal GDP would lead to a decline in the general government deficit to ½ percent of GDP by 2010. This optimistic scenario hinges on firm control over expenditure.

The medium-term projections for the Austrian economy presented here have been developed using the WIFO macro-economic model (Baumgartner – Breuss – Kaniovski, 2005) on the basis of the WIFO short-term forecast of March 2006 (Marter-

A healthier economic climate abroad

bauer, 2006). The details of the international scenario are presented in *Schulmeister (2006)*. Here we recapitulate only most relevant features for Austria.

The external stimulus is expected to strengthen in the next five years. Business activity in Europe is clearly picking up this year, with expectations in particular having improved. Nevertheless, also in the next five years, the pace of growth will remain below that in the USA, due to the European economy trailing that of the USA in both productivity gains and in mobilisation of labour supply. Whether the implementation of the reformed Lisbon strategy can provide an additional impulse remains to be seen.

Table 2: International fundamentals

	Ø 1995-2000	Ø 2000-2005	Ø 2005-2010
	Year-to-year percentage changes		
Gross domestic product, volume			
Austria	+ 2.9	+ 1.5	+ 2.1
EU 25	+ 2.9	+ 1.7	+ 2.1
EU 15	+ 2.8	+ 1.6	+ 2.0
Euro area	+ 2.7	+ 1.4	+ 1.8
23 OECD countries ¹	+ 3.0	+ 2.0	+ 2.4
	Ø 1996-2000	Ø 2001-2005	Ø 2006-2010
	Dollar per ECU or Euro		
Exchange rate	1.10	1.09	1.18
	Dollar per barrel		
Oil price: Average import price (cif) for OECD countries	19.5	32.6	60.7

Source: EU, OECD, WIFO calculations. - ¹ EU 15 (excluding Austria), Iceland, Norway, Switzerland, Turkey, Australia, Japan, Canada, New Zealand, USA.

The growth performance of Germany, Austria's most important trading partner, has been significantly weaker during the last five years than the euro area average. The main reasons were a slump in the construction sector, waning confidence among consumers and investors caused by the need for reform of the social welfare system, and the attractiveness of alternative geographical targets for investment and production. In particular, the high financial burden of re-unification had to some extent crowded out much-needed investment in areas crucial for future growth. From 2006 to 2010 (with the exception of 2007), growth in Germany will only slightly lag behind the average for the euro area, improving the prospects for Austria's exports.

EU enlargement accelerates the pace of medium-term economic growth in the accession countries. Foreign direct investment becomes less risky, and transfers from the EU structural funds support the catching-up process. An increase in competitive pressure in most sectors of the economy coupled with an expansion of foreign trade will lead to higher productivity gains.

The Austrian economy largely benefits from the higher momentum of growth in the new EU member states, as it entertains close economic ties with these countries. In some of them, high current account and government deficits may weigh on growth over the next few years. In Austria, the need for adjustment is greatest in the border regions, in agriculture and on the labour market. The repercussions of EU enlargement on the Austrian labour market will for the larger part materialise only after the expiry of the negotiated transition periods. It is assumed that full liberalisation of the labour market will not be granted before 2011.

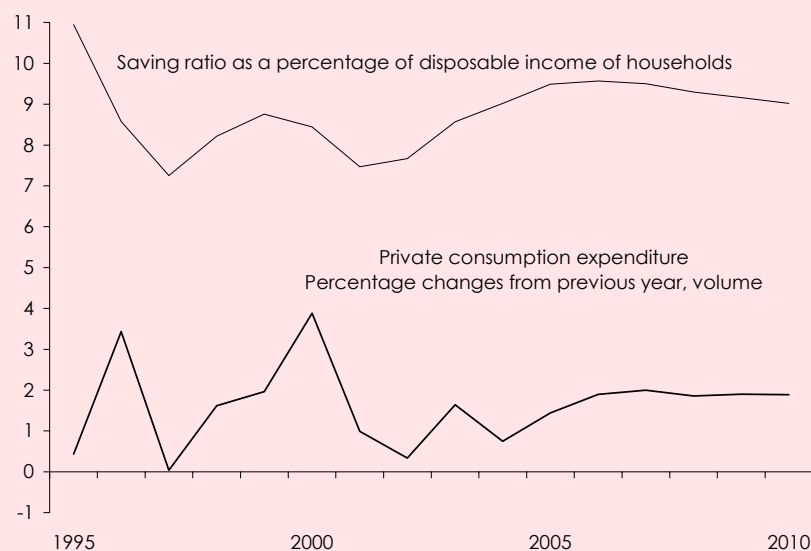
The Austrian economy will benefit from the recovery of demand in the key trading partner countries, as Austrian exports enjoy a high degree of price competitiveness. Real exports are expected to gain 5 percent per year over the period from 2006 to 2010, leading to a further improvement in the external contribution to growth. Past

Positive effects from EU enlargement

Medium-term growth projections for Austria

experience shows that higher exports are followed by increases in investment in machinery, motor vehicles and immaterial production goods.

Figure 1: Private consumption and saving ratio



Source: Statistics Austria, WIFO calculations.

The increase in real disposable income will increase private consumption, which is projected to gain nearly 2 percent p.a. between 2005 and 2010. At the same time, the household saving ratio should abate from its current high level by $\frac{1}{2}$ percentage point by 2010. The latest tax reform has led to an increase in the saving ratio, with a turnaround expected in the next few years. This relatively optimistic projection for private consumption is contingent upon a further strengthening of consumer confidence. The construction sector should overcome its weakness of the last years, owing to rising demand for new homes reinforced by a substantial net migration. Activity in civil engineering is likely to slacken due to the debt incurred from the massive investment undertaken during the last few years.

Table 3: Components of aggregate demand, volume

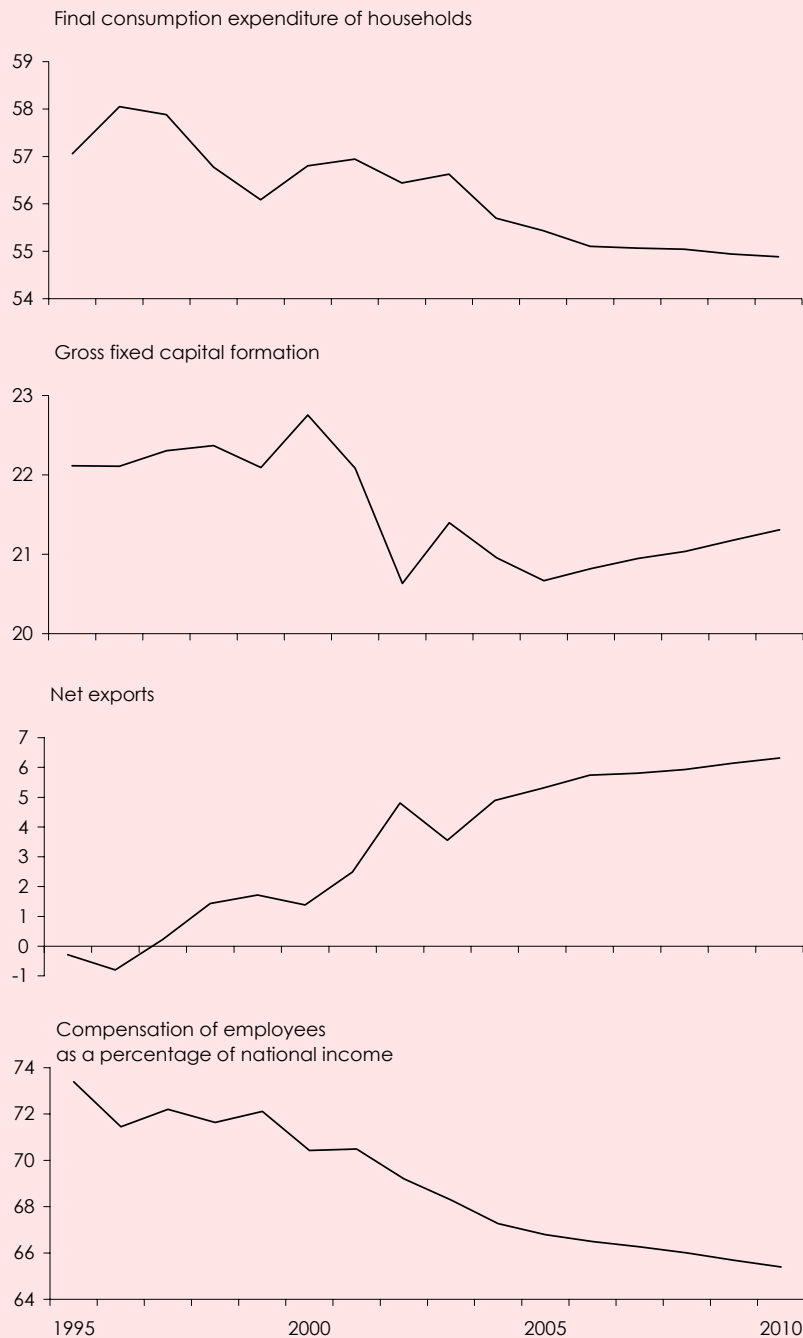
	Ø 1995-2000	Ø 2000-2005	Ø 2005-2010	2005	2006	2007	2008	2009	2010
	Year-to-year percentage changes								
Consumption expenditure									
Private households ¹	+ 2.2	+ 1.0	+ 1.9	+ 1.4	+ 1.9	+ 2.0	+ 1.9	+ 1.9	+ 1.9
General government	+ 2.0	+ 0.8	+ 0.4	+ 1.3	+ 1.3	+ 0.5	+ 0.1	- 0.0	- 0.0
Gross fixed capital formation	+ 3.2	+ 0.2	+ 2.7	+ 0.9	+ 3.2	+ 2.7	+ 2.3	+ 2.8	+ 2.7
Machinery and equipment ²	+ 7.0	+ 0.3	+ 3.5	+ 0.2	+ 4.0	+ 3.5	+ 3.0	+ 3.5	+ 3.4
Construction	+ 0.7	+ 0.0	+ 2.1	+ 1.5	+ 2.5	+ 2.0	+ 1.8	+ 2.2	+ 2.1
Domestic demand	+ 2.3	+ 0.8	+ 1.7	+ 1.0	+ 1.8	+ 1.8	+ 1.6	+ 1.7	+ 1.7
Exports	+ 8.2	+ 5.1	+ 5.0	+ 3.8	+ 5.7	+ 5.0	+ 4.5	+ 5.1	+ 4.9
Imports	+ 6.7	+ 3.8	+ 4.6	+ 1.8	+ 4.9	+ 5.0	+ 4.2	+ 4.6	+ 4.4
Gross domestic product	+ 2.9	+ 1.5	+ 2.1	+ 1.9	+ 2.4	+ 2.0	+ 1.9	+ 2.2	+ 2.1

Q: Statistics Austria, WIFO calculations. – ¹ Including private non-profit institutions serving households. – ² Including other products.

Medium-term growth prospects for Austria are largely determined by the outlook for the European Union. The uncertainties surrounding the European business cycle are therefore of key relevance for Austria. The major risk factor derives from a stronger increase in oil prices which may exceed the underlying assumptions by a wide margin.

Figure 2: Expenditure on GDP and income

As a percentage of GDP, at current prices



Source: Statistics Austria, WIFO calculations.

Judging from the experience of the last ten years, economic growth tends to exceed the OECD- or EU average in countries where

- high investment has been incurred in information and communication technology, research and development as well as education (USA, Finland, Sweden; *Aiginger, 2003*),
- booming real estate prices have fuelled construction activity and private consumption, facilitating a decline in the private household saving ratio (USA, UK, Scandinavia; *Marterbauer – Walterskirchen, 2005*),

- economic policy follows an expansionary stance, e.g., through cuts in taxes or interest rates,
- labour supply is abundant, due to either internal demographic trends or immigration (USA).

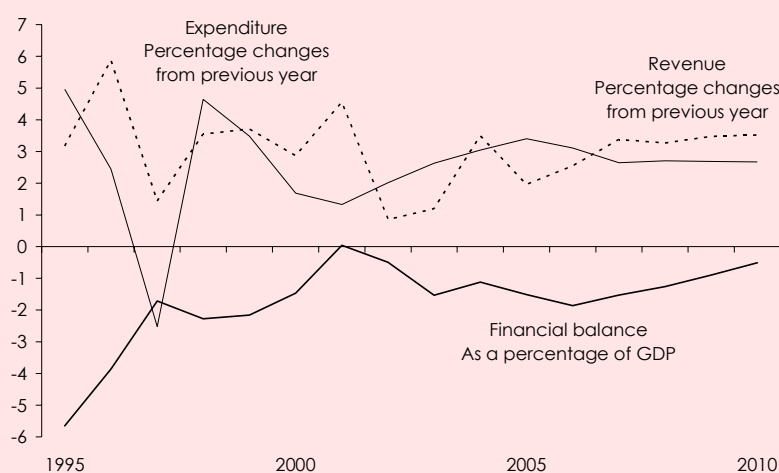
In summary, Austria may expect economic growth above the euro area average over the projection period. Positive contributions come from the tax reform of 2005, EU enlargement as well as current and expected future investment in the immaterial infrastructure.

According to the present forecast, which as far as government expenditure is concerned is guided by that of the Ministry of Finance laid down in the Stability Programme; see *Federal Ministry of Finance (2005)*, the general government deficit will decline to around ½ percent of GDP by 2010¹. On average for the period from 2006 to 2010, the deficit will amount to over 1 percent of GDP. Government finances thereby deviate from the objective defined in the Stability and Growth Pact of a balanced budget over the business cycle, among other things due to an increase in public spending on projects aimed at fostering economic growth that are already decided by the government.

Consolidation of government households

Higher tax revenues from the cyclical revival and a restrictive management of public expenditure will result in a steady decline in the general government deficit to around ½ percent of GDP by 2010.

Figure 3: Revenue, expenditure and financial balance (according to Maastricht) of general government



Source: Statistics Austria, WIFO calculations.

The assessment of the future trend in public finances has to remain vague, since no budget proposals have been laid until 2010 as yet. This projection assumes that the effort towards an administrative reform and greater public sector efficiency will be carried further. Firm control over expenditure will be necessary if the overall tax burden is to be further reduced to 40 percent of GDP by 2010. Over the last ten years, the regional authorities have managed to reduce deficits also by outsourcing, leasing arrangements for public investment projects, changing the promotion of residential building from interest subsidies to loans, etc.². In the longer run, these shifts in financing arrangements (in particular towards leasing) may create new burdens that may make it difficult for the Federal states and the communities to meet their budgetary targets. The loans taken by the motorway financing agency ASFINAG and the

¹ While the trend in revenues, at given tax rates, is largely obtained endogenously from the macro model, exogenous assumptions were made for the expenditure side which for the major part follow the Stability Programme; the latter, however, extends only until 2008.

² Largely because of such transfers off-budget, the share of public investment has fallen from 3 percent of GDP in 1995 to 1.1 percent in 2005.

Federal Railways ÖBB to finance the large-scale investment in road and railroad infrastructure will likely to be serviced by tolls and an increase in equity capital.

Table 4: General government

At current prices

	Ø 1995-2000	Ø 2000-2005	Ø 2005-2010	2005	2006	2007	2008	2009	2010
	Year-to-year percentage changes								
Current revenue	+ 3.5	+ 2.4	+ 3.2	+ 2.0	+ 2.5	+ 3.4	+ 3.3	+ 3.5	+ 3.5
Current expenditure	+ 1.9	+ 2.5	+ 2.8	+ 3.4	+ 3.1	+ 2.6	+ 2.7	+ 2.7	+ 2.7
Gross domestic product	+ 3.7	+ 3.2	+ 4.1	+ 4.0	+ 4.3	+ 4.0	+ 3.8	+ 4.1	+ 4.0
	Ø 1996-2000	Ø 2001-2005	Ø 2006-2010	2005	2006	2007	2008	2009	2010
	As a percentage of GDP								
General government financial balance (Maastricht definition)	- 2.3	- 0.9	- 1.2	- 1.5	- 1.9	- 1.5	- 1.3	- 0.9	- 0.5

Q: Statistics Austria, WIFO calculations.

The pace of economic growth is the key determinant for the trend in employment. The projected average increase in real GDP of 2.1 percent per year should lead to a net increase in the number of jobs by nearly 28,000 or 0.9 percent p.a. The Lisbon goals will broadly be met with regard to the overall participation rate (70 percent) and the rate of female participation (60 percent). At the same time, the labour market will be considerably short of meeting the Lisbon goals with regard to participation of older workers (50 percent).

As during the last years, a considerable proportion of the jobs newly created will be part-time, as temporary employment contracts play a relatively minor role in Austria. In the last five years, Austria has turned from a laggard among the EU member states to a country with an above-average share of part-time jobs. While the labour market should continue to become more flexible within the next years, the share of part-time jobs is unlikely to rise as much as it has done in the past years, even if the bulk of new jobs will be offered in sectors where part-time work is widespread, i.e., commercial services, health and nursing care, trade and tourism.

No decline in unemployment

Table 5: Labour market, income

	Ø 1995-2000 ¹	Ø 2000-2005 ¹	Ø 2005-2010 ¹	2005	2006	2007	2008	2009	2010
	Year-to-year percentage changes								
Active dependent employment ²	+ 0.6	+ 0.4	+ 0.9	+ 1.0	+ 1.1	+ 0.9	+ 0.7	+ 0.8	+ 0.9
Registered unemployed	- 2.1	+ 5.4	+ 1.4	+ 3.6	- 1.2	+ 2.0	+ 2.6	+ 1.6	+ 2.0
Unemployment rate									
As a percentage of total labour force ³	.	.	5.3	5.2	5.2	5.2	5.3	5.3	5.4
As a percentage of dependent labour force ⁴	6.8	6.9	7.3	7.2	7.1	7.2	7.3	7.3	7.4
Productivity ⁵	+ 1.9	+ 1.3	+ 1.3	+ 1.3	+ 1.6	+ 1.2	+ 1.0	+ 1.3	+ 1.2
Gross wages and salaries ⁶	+ 2.8	+ 2.4	+ 3.6	+ 3.4	+ 4.0	+ 3.5	+ 3.4	+ 3.6	+ 3.6
Per employee ⁷	+ 1.8	+ 2.0	+ 2.6	+ 2.4	+ 2.8	+ 2.5	+ 2.5	+ 2.7	+ 2.7
Unit labour costs, total economy	- 0.2	+ 0.7	+ 1.3	+ 1.1	+ 1.2	+ 1.2	+ 1.4	+ 1.3	+ 1.5

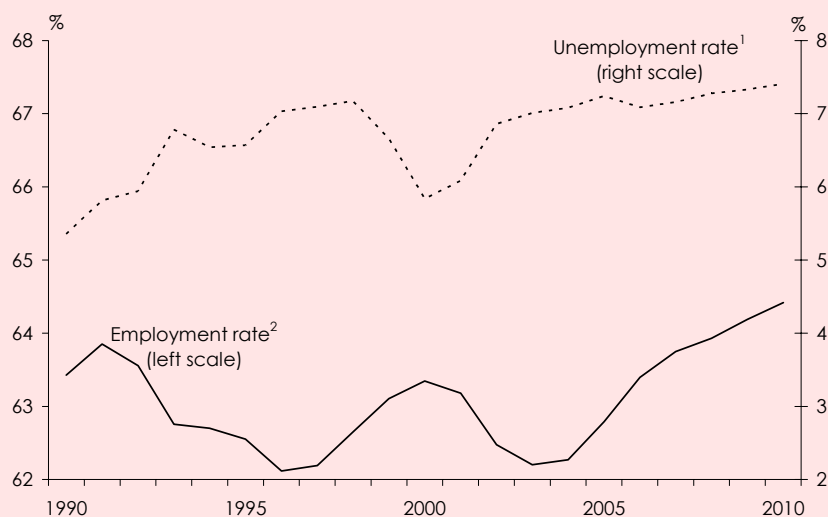
Source: Federation of Austrian Social Security Institutions, Statistics Austria, WIFO calculations. – ¹ Unemployment rate: Ø 1996-2000, Ø 2001-2005, Ø 2006-2010 – ² Excluding parental leave, military service, and unemployed persons in training. – ³ According to Eurostat Labour Force Survey. – ⁴ According to Labour Market Service. – ⁵ Real GDP per employment (dependent and self-employed according to National Accounts definition). – ⁶ Excluding employers' contributions. – ⁷ Employees according to National Accounts definition.

When forecasting economic growth, a particular attention should be paid to the medium-term trend in productivity. Over the next five years, hourly productivity and real GDP per full-time employee are expected to advance by nearly 2 percent p.a.,

respectively. However, the growing number of part-time and mini-jobs will reduce productivity gains as measured by GDP per employee to 1.2 percent p.a.

The increase in the number of jobs will not be enough to reduce unemployment; indeed, the number of jobseekers will rise somewhat further. For the period from 2006 to 2010, the average rate of unemployment is projected at 7.3 percent of the dependent labour force, or 5.3 percent of the total labour force according to Eurostat definitions. However, the medium term projection is subject to considerable uncertainty, as measured unemployment is strongly influenced by institutional changes (job training, temporary interruptions of existing work contracts etc.).

Figure 4: Labour market trends



Source: Labour Market Service, WIFO calculations. – ¹ As a percentage of total labour force (according to labour Market Service). – ² Pensions in active employment as a percentage of population of working age (15 go 64).

Unemployment proves sticky due to labour supply rising strongly and the majority of the unemployed is seeking full-time jobs. The domestic labour force is boosted by the increase in the early retirement age and a pro-cyclical variation in the participation rate. Immigration of foreign workers, their family members and asylum seekers is set to remain high. Yet, a substantial part of additional foreign labour will comprise of those residents which currently remain without a work permit (*Biffi – Bock-Schappelwein, 2003*). Since the average qualification level of foreign workers is below that of domestic workers, the need for measures facilitating integration and life-long learning becomes ever more urgent.

Immigration pushes the demographic burden further into the future, alleviating it at the same time. The predominantly young immigrants not only increase the current population, but in the longer run also the number of births. On current projections, a significant decline in the working-age population will not set in before 2020. This has major implications for the prospects as regards retirement financing and a scarcity of qualified labour.

The medium-term outlook does not point to any major inflationary risk. From 2006 to 2010, consumer prices will rise by a moderate 1.9 percent on annual average. Persistent high unemployment will dampen negotiated wage increases. The price of oil, which will remain a key driver of inflation, is assumed to rise but only slightly. Moreover, with economic growth staying moderate, capacity shortages should not become a concern.

In an open economy with strong external trade linkages, import prices are a key determinant of domestic inflation. Competitive pressure is likely to increase further with

**Modest price
increases**

globalisation and EU enlargement, putting a lid on the rise in consumer prices. Risks to this optimistic scenario lie in oil and commodity prices, as underlined by the current peak in the price of crude oil.

Table 6: Implicit price indices

	Ø 1995-2000	Ø 2000-2005	Ø 2005-2010	2005	2006	2007	2008	2009	2010
	Year-to-year percentage changes								
Private consumption	+ 1.4	+ 1.7	+ 1.9	+ 2.0	+ 1.7	+ 1.9	+ 1.9	+ 2.0	+ 2.0
Exports	+ 1.0	+ 0.8	+ 1.1	+ 1.6	+ 1.1	+ 0.8	+ 0.8	+ 1.3	+ 1.3
Imports	+ 1.6	+ 0.5	+ 1.3	+ 2.8	+ 1.3	+ 0.9	+ 0.9	+ 1.6	+ 1.7
Gross domestic product	+ 0.7	+ 1.7	+ 1.9	+ 2.0	+ 1.8	+ 1.9	+ 1.9	+ 1.9	+ 1.9

Source: Statistics Austria, WIFO calculations.

Domestic determinants of inflation do not exhibit a significant upward drift. At this moment, there are no plans to increase indirect taxes, which, if raised, would put pressure on consumer prices. Some risks relate to developments of administered prices such as road tolls or communal charges. Past experience shows that public charges and indirect taxes have repeatedly been increased in order to reduce the general government deficit or to compensate for revenue losses from income tax cuts.

Nominal unit labour costs for the whole economy are set to rise by only about 1¼ percent per year over the projection period. Real per-capita wages will continue to trail the gains in labour productivity. Thus, the share of wages in GDP will continue to follow the downward trend prevailing since the early eighties. The decline in real unit labour costs of about ½ percent p.a., while strengthening Austria's international price competitiveness, will weigh on disposable income of private households.

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Projections for the Austrian Economy until 2010 – Summary

The Austrian economy is expected to grow by 2.1 percent per year until 2010, exceeding the average rate for the euro area. The increase in external demand and the high competitiveness of domestic companies will drive exports in the years to come. The upgrading of the transportation infrastructure and the expected revival of residential building will boost construction output. Also, private household consumption should progressively pick up from its extended stagnation of the past years. However, the overall expansion is unlikely to be strong enough as to make inroads into unemployment. Against this background, price and wage increases will remain moderate. With the impact of the 2005 tax reform waning, the general government deficit should steadily decline, provided the authorities maintain a stance of sustained restraint on expenditure.

With the economic climate in Europe brightening, economic activity should gain momentum in the course of 2006. After a temporary setback caused by the VAT increase in Germany, demand and output are set to resume a moderate upward trend until the end of the decade. While the major risk is deemed to derive from a new jump in oil prices, a rise in the euro exchange rate may also slow the pace of growth in Europe in the medium term.

Austria's gross domestic product is projected to increase by an annual average 2.1 percent between 2006 and 2010, significantly above the 1.5 percent p.a. observed for the period from 2001 to 2005, when economic activity in Austria was held back by the cyclical weakness across Europe. With activity in Europe expected to gain momentum, the Austrian growth rate should return to its long-term trend. The increase in labour supply will offer sufficient leeway in that regard.

Several factors support the assumption that Austria's medium-term growth will exceed the euro area average:

- Austria's price competitiveness, as measured by unit labour costs, will further improve, thereby strengthening Austria's export capacity.
- In addition, Austrian companies profit to a high degree from the latest round of EU enlargement, with Austria being among the key trading partners of these fast-growing economies.
- Germany's weak economic performance in recent years has been weighing on activity in Austria. In the years to come, Germany should be able to reduce its growth lag, with the regained dynamism expected to spill over to Austria.
- Labour supply, notably from foreign source, will continue to rise strongly over the next few years. While this will boost activity and employment in sectors facing labour shortages, it reduces at the same time the prospect for a decline in unemployment.
- The priority given by economic policy to the promotion of research and development should bear fruit in the medium term. In addition, growth in 2006 and 2007 should benefit from the impact of the last tax reform. Domestic fiscal policy is providing somewhat stronger growth incentives than policy in those European countries where high deficits exert pressure for consolidation (notably in Germany, France and Italy).

In an environment of world-wide structural adjustment, Austria will only be able to maintain its relatively high living standards if it is ready to reinforce investment in forward-looking areas such as research and development, education, infrastructure as well as information and communication technologies. It is in these areas where the foundations for an economy's future growth potential are laid.

According to the present medium-term projections, growth of Austria's GDP of 2.1 percent p.a. in volume is set to exceed the average for both the EU 15 (+2.0 percent) and the euro area (+1.8 percent).

Nevertheless, the projected pace of growth will not allow the rate of unemployment to fall substantially, since notably supply of domestic and foreign labour will increase markedly. Although employment is expected to gain a healthy 0.9 percent p.a., the jobless rate is likely to remain high up to the forecast horizon, i.e., at 5.4 percent according to Eurostat or 7.4 percent on national definitions.