

Christian Glocker

Recovery Subject to Significant Uncertainty

Economic Outlook for 2014 and 2015

Recovery Subject to Significant Uncertainty. Economic Outlook for 2014 and 2015

Short-term prospects for the Austrian economy have little changed since the last revision of the WIFO forecast three months ago. Output in the first quarter 2014 grew as expected, albeit somewhat less than in the fourth quarter 2013. Latest leading indicators have been slightly less strong than anticipated. After a modest gain of 0.3 percent in 2013, growth of real GDP is projected to strengthen to 1.4 percent in 2014 and 1.7 percent in 2015.

Contact:

Christian Glocker: WIFO, 1030 Vienna, Arsenal, Objekt 20, Christian.Glocker@wifo.ac.at

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Data processing: Astrid Czaloun (Astrid.Czaloun@wifo.ac.at), Maria Riegler (Maria.Riegler@wifo.ac.at)

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In the second half of 2013, the Austrian economy resumed an upward path, although the pace of growth has been slow so far altogether. The lively momentum observed as from the third quarter 2013 slackened in the first three months of the current year. Yet, there are firm reasons to believe that demand and output will again pick up in the months to come. Thus, monthly figures for incoming orders and order levels were heading up, also driven by lively foreign demand. Likewise, domestic business conditions remain conducive to an upswing of activity. Major risks derive from the external economic environment, notably for export prospects in the face of the uncertain political outlook for some of southern and eastern neighbour countries.

After a modest 0.3 percent in 2013, growth of the Austrian economy is set to accelerate to 1.4 percent in 2014 and 1.7 percent in 2015. The underlying key assumption is a gradual dwindling of uncertainty on the part of investors and consumers in the absence of a rekindling of the euro area debt crisis and of geopolitical conflicts.

Despite the gradual strengthening of growth, inflation pressure should remain subdued over the forecast horizon, as capacity utilisation will remain below average and the output gap is not expected to close by end-2015. Headline inflation is projected at 1.8 percent, respectively, in 2014 and 2015, down from a rate of 2 percent in 2013. Besides a moderate, but steady increase in private consumption, investment is expected to rebound firmly over the forecast period. Both employment and labour supply will continue to expand, implying little change in unemployment from its current high level. The net contribution to GDP growth from the external sector will be close to zero in 2014 and 2015: while the outlook for Austrian exports has improved during the last months, a lasting revival may not be expected before the end of 2015, given the persistent sluggishness in the euro area which takes up slightly over 50 percent of Austria's exports.

Table 1: Main results

		2010	2011	2012	2013	2014	2015
		Percentage changes from previous year					
GDP							
Volume		+ 1.8	+ 2.8	+ 0.9	+ 0.3	+ 1.4	+ 1.7
Value		+ 3.2	+ 4.9	+ 2.6	+ 2.0	+ 3.2	+ 3.6
Manufacturing ¹ , volume		+ 7.6	+ 8.3	+ 1.1	+ 1.3	+ 2.5	+ 4.0
Wholesale and retail trade, volume		+ 2.2	+ 1.3	- 1.7	- 1.4	+ 1.0	+ 2.0
Private consumption expenditure, volume		+ 2.0	+ 0.8	+ 0.5	- 0.2	+ 0.8	+ 1.0
Gross fixed investment, volume		- 1.4	+ 8.5	+ 1.6	- 0.7	+ 2.5	+ 2.1
Machinery and equipment		+ 2.1	+ 14.3	+ 2.1	- 3.4	+ 4.0	+ 3.0
Construction		- 3.9	+ 2.5	+ 2.5	+ 1.2	+ 1.2	+ 1.3
Exports of goods ²							
Volume		+ 13.6	+ 8.1	+ 0.8	+ 2.7	+ 4.8	+ 6.5
Value		+ 16.7	+ 11.3	+ 1.5	+ 1.5	+ 5.0	+ 7.7
Imports of goods ²							
Volume		+ 11.7	+ 8.6	- 1.3	+ 0.3	+ 4.8	+ 6.0
Value		+ 16.5	+ 15.3	+ 0.7	- 1.5	+ 4.8	+ 7.0
Current balance	billion €	+ 9.74	+ 4.90	+ 7.33	+ 8.45	+ 8.94	+ 11.31
As a percentage of GDP		+ 3.4	+ 1.6	+ 2.4	+ 2.7	+ 2.8	+ 3.4
Long-term interest rate ³	percent	3.2	3.3	2.4	2.0	1.7	1.9
Consumer prices		+ 1.9	+ 3.3	+ 2.4	+ 2.0	+ 1.8	+ 1.8
Unemployment rate							
Eurostat definition ⁴	percent	4.4	4.2	4.3	4.9	5.2	5.3
National definition ⁵	percent	6.9	6.7	7.0	7.6	8.1	8.3
Persons in active dependent employment ⁶		+ 0.8	+ 1.9	+ 1.4	+ 0.6	+ 0.9	+ 0.9
General government financial balance according to Maastricht definition							
As a percentage of GDP		- 4.5	- 2.5	- 2.6	- 1.5	- 2.8	- 1.7

Source: WIFO. 2014, 2015: forecast. – 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 According to Public Employment Service Austria, as a percentage of total labour force excluding self employed. – ⁶ Excluding parental leave, military service.

Despite the slow momentum of the recovery, public finances are unlikely to turn out weaker than projected last March. For 2014, the general government deficit (Maastricht definition) is expected at 2.8 percent of GDP, possibly narrowing to 1.7 percent of GDP in 2015.

1. Global economic environment remains favourable

World economic growth picked up with the revival of manufacturing activity during 2013, but lost momentum in early 2014, partly due to temporary factors like the extremely cold winter in North America. The underlying strength of the global recovery remained intact and should increase in the course of 2014, notably in the advanced economies where debt reduction by private households is gradually abating and the need for further fiscal consolidation becomes less pressing in many countries. Together with some relief in labour market conditions this should support domestic demand, and in addition monetary policy remains expansionary. Against this background, the industrialised economies can expect a significant increase in overall demand and, with important productive capacity reserves being available, an acceleration of GDP growth.

In the euro area, economic recovery continued during the first six months of 2014, as also suggested by several confidence indicators: companies as well as private households judged their economic prospects more positively than six months earlier; incoming orders in manufacturing also point in the same direction. The dampening

Growth of the world economy is continuing, although it slowed somewhat in the first quarter 2014, a tendency observed both in the industrialised countries and the emerging market economies. In the latter, signs of renewed financial market turbulence early in the year ebbed soon thereafter.

effects of structural adjustment, such as the shrinking of the construction sector in Spain, are gradually abating, while fiscal policy turns somewhat less restrictive. Capacity utilisation in manufacturing is improving, prompting firms to invest in new production facilities beyond the replacement of obsolete equipment. However, in the countries most affected by the crisis, a vigorous cyclical upturn is held back by domestic constraints that are easing only gradually. Thus, high unemployment is set to decline only in small steps and debt burdens remain high both in the private and the public sector. A strong rebound in investment will not set in as long as bank lending is squeezed by the still unresolved problems and balance sheet adjustment in the financial sector. Overall output is projected to expand by 1.0 percent in 2014, rising to 1.6 percent in 2015. With the recovery gaining ground, the output gap is expected to narrow and inflation to pick up.

Table 2: World economy

	2010	2011	2012	2013	2014	2015
	Percentage changes from previous year					
<i>Real GDP</i>						
World	+ 5.2	+ 3.9	+ 3.2	+ 3.0	+ 3.3	+ 3.8
USA	+ 2.5	+ 1.8	+ 2.8	+ 1.9	+ 2.2	+ 3.1
Japan	+ 4.7	- 0.5	+ 1.4	+ 1.5	+ 1.7	+ 1.2
EU 28	+ 2.0	+ 1.7	- 0.4	+ 0.1	+ 1.4	+ 1.9
Euro area 18	+ 2.0	+ 1.6	- 0.6	- 0.4	+ 1.0	+ 1.6
Germany	+ 4.0	+ 3.3	+ 0.7	+ 0.4	+ 1.9	+ 2.0
CEE ⁵	+ 3.1	+ 3.2	+ 0.6	+ 0.8	+ 2.9	+ 2.9
China	+ 10.4	+ 9.3	+ 7.7	+ 7.7	+ 7.3	+ 7.3
World trade, volume	+ 14.5	+ 6.1	+ 1.9	+ 2.7	+ 5.0	+ 6.5
Market growth ²	+ 14.5	+ 7.6	+ 1.3	+ 1.7	+ 4.5	+ 6.5
<i>Primary commodity prices³</i>						
HWI index, total	+ 28.9	+ 28.6	- 2.8	- 1.9	+ 1	± 0
Excluding energy	+ 31.9	+ 19.2	- 14.4	- 6.1	± 0	± 0
<i>Crude oil prices</i>						
Brent, \$ per barrel	79.5	111.3	111.6	108.7	110	110
<i>Exchange rate</i>						
\$ per euro	1.327	1.392	1.286	1.328	1.35	1.35

Source: WIFO. 2014, 2015: forecast. – ¹ Czech Republic, Hungary, Poland, Slovakia, Slovenia. – ² Real import growth of goods of trading partners weighted by Austrian export shares. – ³ Dollar.

Growth in the emerging market economies slackened, due to sluggish domestic demand and the limited scope of policy for further stimulative action. With the latest financial and macroeconomic imbalances prevailing, these countries will contribute distinctly less to world economic growth than on average during the last ten years. Although financial markets in the emerging economies moved from a period of heightened volatility towards greater stability in early 2014, financing conditions have nevertheless deteriorated significantly in many countries since mid-2013. In a number of emerging markets, growth is constrained by structural deficiencies such as bottlenecks in infrastructure and productive capacity. Economies that were highly dependent on capital inflows suffered from the drain of funds caused inter alia by the normalisation of US monetary policy slowly setting in.

Overall, while expected growth of global GDP of 3.3 percent in 2014 may exceed the rate of the previous year, it is revised down from the forecast of last March, largely on account of the weak performance early in the year. For 2015, the projection is for a slight acceleration to a rate of 3.8 percent. World trade will see an only moderate expansion of 5.0 percent on annual average 2014, given the sluggishness in the first few months, before picking up to +6.5 percent in 2015. Austrian export markets will expand somewhat less than global trade, due to the high weight of the but slowly recovering euro area.

2. Persistent positive outlook for the Austrian economy

GDP growth over the last years has been disappointingly slow in a long-term perspective. Nevertheless, activity in Austria fared relatively well compared with the euro area average, notably in 2012 and 2013. After a year of stagnation, moderate growth resumed as from the middle of 2013. In the last few months, Austria has been largely spared from macroeconomic shocks: the external environment failed to provide major incentives in the first quarter, and domestic orders to manufacturing mirror firms' low appetite for investment. As a result, GDP edged up by only 0.2 percent from the previous period in the first quarter 2014. As many indicators suggest, the Austrian economy should keep on the slow upward trend observed in the first quarter for the remainder of the year. The annual growth rate also stands to benefit from a good starting position, as the strong expansion in the last three months of 2013 (+0.4 percent quarter-on-quarter) creates a substantial positive carry-over of 0.4 percent for 2014, in a similar way as for Germany and the euro area at large.

Unlike for the forecast of last March, leading indicators now convey a largely uneven picture: in May, Bank Austria's Purchasing Managers' Index fell to its lowest reading since mid-2013. The monthly survey shows a deceleration in industrial activity with modest gains in production due to lacklustre order inflows. The weakening signals from leading indicators are confirmed by the regular WIFO Business Cycle Survey: in May, Austrian companies rated current business conditions less positive than in April; the index declined on a seasonally adjusted basis more or less across the entire economy. However, expectations for the next few months are more upbeat, as firms in all sectors judged the international cyclical risks lower in May than in the month before. The WIFO Leading Indicator barely changed month-on-month in June, while its components show widely differing developments: whereas the partial indicators for manufacturing pointed up, the consumer climate and business confidence in the retail sector weakened significantly. Thus, in keeping with the slight setback to growth early this year, the general business sentiment is characterised by a high degree of uncertainty.

2.1 Economic growth set to accelerate

After the modest gain early this year, demand and output in Austria should strongly gather momentum in subsequent months. Several factors underpin the positive outlook. First, results for the first quarter have likely been depressed by latest financial market turbulences in Austria (Figure 1). According to a macroeconometric assessment¹, the strong financial market stress prevailing in October and November 2013 has been reflected in frictions in the real economy at a probability of 0.69. Transmission operates through several channels, the most straightforward one being precautionary saving and the implicit restraint on consumption and investment. Since financial market turbulence ebbed quickly, it is no longer an element of uncertainty weighing on growth ahead. Second, activity in manufacturing is likely to rebound, as witnessed by the rise in industrial orders in the first quarter against the previous period. Industrial output may thus post significant gains in the months to come, all the more so since the increasing order inflow during 2013 has not been fully reflected in output gains so far (probably due to production smoothing by firms). Moreover, short-term output expectations of manufacturers remain upward bound, according to the regular WIFO Business Cycle Survey.

In a short-term perspective, the conditions for a gradual recovery of growth in Austria are in place. Among these are the expected revival in the industrialised countries and the euro area, as well as firmer domestic demand. The latter is benefiting from the high level of overall employment, the low jobless rate comparative to other industrialised countries, further immigration, the relatively sound financial situation of private households and the public sector, low corporate debt and highly favourable

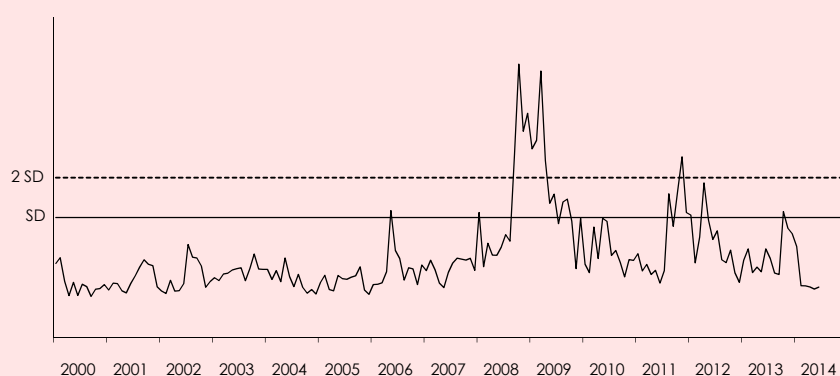
The Austrian economy remains characterised by positive fundamentals. Although growth in the first quarter 2014 turned out lower than expected, conditions for more buoyant activity in the months to come are in place. The risk environment has little changed from the WIFO forecast of last March.

The increase in GDP of 1.4 percent projected for the current year corresponds somewhat to the trend rate. The expected acceleration to 1.7 percent in 2015 will not suffice for closing the output gap. Given the below-average degree of capacity utilisation, inflationary pressure should remain subdued.

¹ Glocker, Ch., Kaniowski, S., "A financial market stress indicator for Austria", *Empirica*, 2014, 41(3).

financing conditions. In such a scenario, both foreign demand and domestic consumption and investment should pick up markedly.

Figure 1: Financial Market Stress Indicator for Austria



Source: WIFO. SD . . . Standard Deviation.

In this environment, Austria's GDP is projected to expand by almost 1.4 percent in 2014; in 2015, growth is expected to accelerate to 1.7 percent (growth during the year, i.e. fourth quarter year-on-year: 2014 +1.7 percent, 2015 +1.6 percent). Actual growth would thus exceed that of potential output, such that overall capacity utilisation would rise significantly from the current "average" degree, without the output gap being closed, however, over the forecast horizon.

Table 3: Productivity

	2010	2011	2012	2013	2014	2015
	Percentage changes from previous year					
<i>Total economy</i>						
Real GDP	+ 1.8	+ 2.8	+ 0.9	+ 0.3	+ 1.4	+ 1.7
Hours worked ¹	- 0.1	+ 2.3	- 0.0	- 0.8	+ 0.5	+ 0.5
Productivity per hour	+ 1.9	+ 0.5	+ 0.9	+ 1.1	+ 0.9	+ 1.2
Employment ²	+ 0.7	+ 1.8	+ 1.4	+ 0.7	+ 1.0	+ 1.0
<i>Manufacturing</i>						
Production ³	+ 7.8	+ 8.3	+ 1.2	+ 1.5	+ 2.5	+ 4.0
Hours worked ¹	+ 1.6	+ 1.4	+ 0.6	- 1.2	- 0.6	+ 0.3
Productivity per hour	+ 6.1	+ 6.9	+ 0.6	+ 2.7	+ 3.1	+ 3.7
Employees ¹	- 1.3	+ 1.7	+ 1.1	- 0.0	- 0.1	+ 0.2

Source: WIFO. 2014, 2015: forecast. – ¹ According to National Accounts definition. – ² Dependent and self-employed according to National Accounts definition. – ³ Value added, volume.

The current growth projection is revised down by 0.3 percentage points from the previous WIFO forecast of last March. This is the consequence of partly opposite effects: on the one hand, higher-than-expected GDP growth in the fourth quarter 2013 implies a higher carry-over into 2014; on the other hand, unexpectedly sluggish activity in the first three months of the current year and weak signals from leading indicators require a small downward adjustment of the annual GDP growth rate for 2014.

2.2 Negative external growth contribution in 2014

Current export performance is largely shaped by the sluggishness on foreign markets. In 2013, some of Austria's export markets in the euro area even contracted slightly. Overall exports nevertheless recorded a modest increase. Going forward, the highly export-oriented Austrian economy should benefit from the brightening international environment. On key export markets and in Germany in particular, conditions appear to normalise and return to pre-crisis levels. Growth of Austria's export markets is expected to strengthen from 4.5 percent in 2014 to 6.5 percent in 2015, while still remaining below the trend observed before the crisis. Due to the recovery

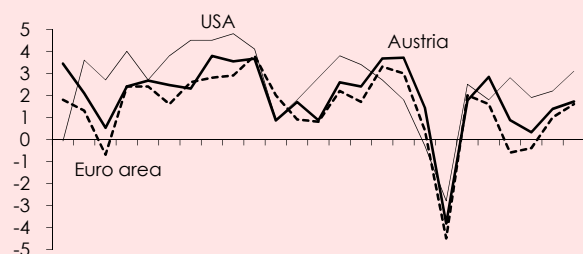
Due to a substantial increase in imports, the balance of foreign trade will not add to GDP growth in 2014. In 2015, the external growth contribution should turn positive again.

of foreign markets, Austria's exports should enjoy a slow, but steady increase in momentum in 2014. By 2015, volume export growth should reach almost 6.5 percent, thereby converging to its long-term average.

Figure 2: Indicators of economic performance

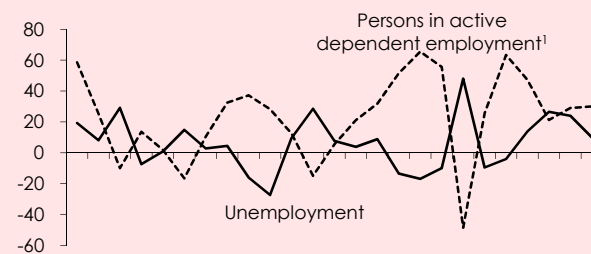
Growth of real GDP

Percent



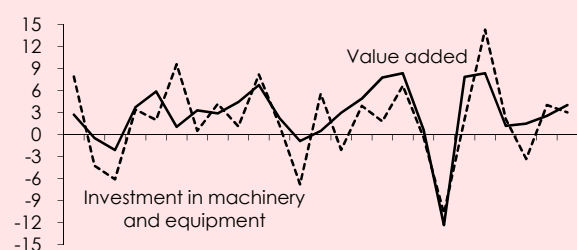
Employment and unemployment

1,000 from previous year



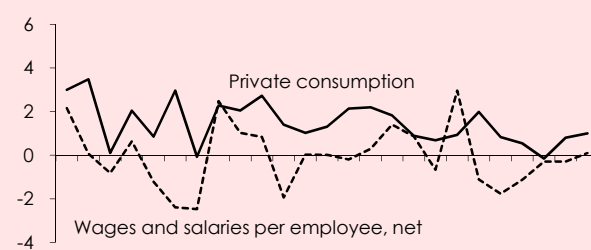
Manufacturing and investment

Percentage changes from previous year, volume



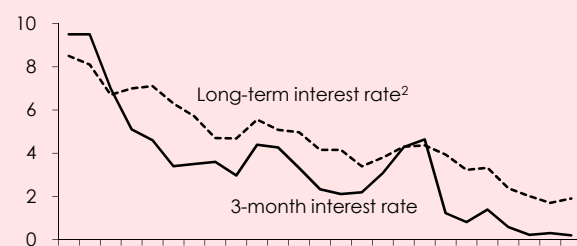
Consumption and income

Percentage changes from previous year, volume



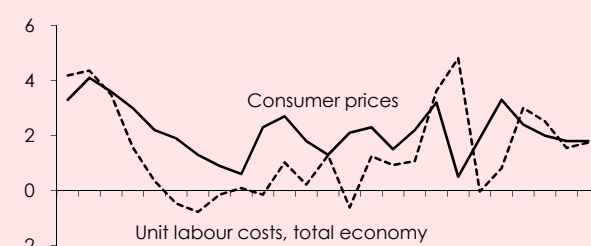
Short-term and long-term interest rates

Percent



Inflation and unit labour costs

Percentage changes from previous year



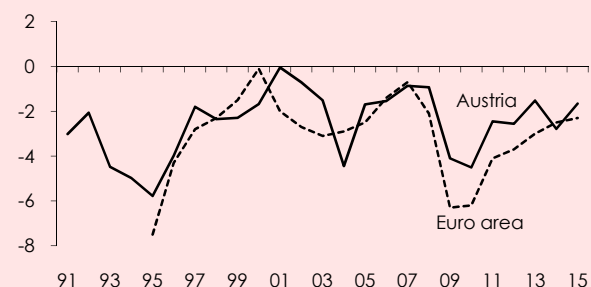
Trade

Percentage changes from previous year, volume



General government financial balance

As a percentage of GDP



Source: WIFO. 2014, 2015: forecast. - ¹ Excluding parental leave, military service, and unemployed persons in training. - ² 10-year central government bonds (benchmark).

Import growth is also forecasted to rebound strongly over the forecast horizon. Apart from the high import content of exports, buoyant domestic demand will be the main driver in 2014. Lively investment and purchases of durable consumer goods – both

components exhibiting a high import ratio – will push volume import growth to 4.8 percent in 2014. The contribution of foreign trade to GDP growth will thus be slightly negative in 2014, before turning slightly positive again in 2015.

2.3 Replacement of productive equipment provides strong growth stimulus

Despite favourable internal and external financing and refinancing conditions in Austria, the recession in the euro area with its shortfall in overall demand and rising uncertainty led to a decline in gross fixed investment by 0.7 percent in volume in 2013. In addition, the run-down of inventories has been weighing on investment and growth for two years by now.

Given the sluggishness of investment prevailing since 2012, the need for replacement of equipment should meanwhile be high. In view of better sales prospects, rising capacity utilisation and highly favourable financing conditions, a rebound in corporate investment is likely. Higher spending on machinery, equipment and commercial buildings will primarily be devoted to replacement and modernisation of existing facilities. Also investment projects planned earlier, but postponed in a climate of low confidence and uncertainty, may now be carried out in 2014. Leading indicators like order inflows from abroad or imports of machinery and vehicles (largely being investment goods) have been signalling a brightening of sentiment for some time. Internal and external financing conditions remain favourable. Since capacity utilisation is heading up and has returned to its long-term average, part of investment will also serve to increase the productive potential.

WIFO projects a growth of gross fixed investment by 2.5 percent in 2014 and 2.1 percent in 2015, mainly driven by purchases of new machinery and equipment. The latter are particularly volatile over the business cycle as they are primarily shaped by firms' sales prospects in relation to their available production capacity. In 2012, they increased by 2.1 percent in volume, before falling in reaction to weak exports in 2013, uncertainty related to the euro area debt crisis and with the effects of the fiscal stimulus "packages" adopted during the financial market crisis 2008-09 fading out.

Subdued sentiment in the construction sector is likely to dampen investment in 2014, followed by a tentative pick-up in 2015. While residential building had accounted for some 6 percent of GDP in the late 1990s, the ratio had dropped to 4.3 percent by 2007. Since the onset of the global financial market crisis and the severe recession, the share of residential construction in total investment is rising again in Austria. The persisting benign financing conditions and the upward drift in real estate values may give rise to a still stronger revival over the forecast period.

2.4 Private consumption heading up again

Private consumption expenditure strengthened somewhat, from a low level, in the course of 2013 and in early 2014. For the current year, the projection is for an average increase of 0.8 percent in real terms, followed by +1 percent in 2015, unchanged from the forecast of last March. Purchases of motor cars carried forward in view of the hike in the car registration tax as from 1 March 2014 turned out somewhat lower than anticipated. While private households' readiness to spend on durable goods (like cars or furniture) is rising in 2014 and 2015, it still remains moderate altogether. Uncertainty of consumers is also witnessed by a decline in confidence during the last months². The weakening of the consumer climate is mainly driven by a more pessimistic assessment of labour market prospects.

After a fall in 2013, real disposable income of private households is projected to head up in 2014 and 2015, rising by 0.9 percent and 1.6 percent respectively. Whereas net wages per capita will decline further in real terms in 2014, income from property and wealth is set to recover in both years from the substantial losses in-

With the cyclical recovery progressing, investment is set to revive. Higher exports will give incentives notably to demand for machinery and equipment which is projected to post above-average gains over the forecast horizon. Construction investment will increase only little in 2014.

² As measured by the Consumption Climate Indicator of the European Commission

curred in 2013. The private household saving ratio will edge up marginally in 2014, by 0.1 percentage point, but more markedly in 2015, since gains from private assets are usually put to saving accounts rather than being spent. At a projected 7.3 percent of disposable income in 2015, the saving ratio will however remain very low by historical standards.

Table 4: Private consumption, income and prices

	2010	2011	2012	2013	2014	2015
	Percentage changes from previous year					
Private consumption expenditure	+ 2.0	+ 0.8	+ 0.5	- 0.2	+ 0.8	+ 1.0
Durables	+ 1.6	+ 1.8	+ 0.6	- 2.2	+ 2.0	+ 1.5
Non-durables and services	+ 2.0	+ 0.7	+ 0.5	+ 0.1	+ 0.7	+ 0.9
Household disposable income	- 0.5	- 1.3	+ 1.1	- 1.1	+ 0.9	+ 1.6
	As a percentage of disposable income					
Household saving ratio ¹	8.9	6.7	7.4	6.6	6.7	7.3
Household saving ratio ²	8.4	6.4	7.0	6.2	6.3	6.9
	Percentage changes from previous year					
Direct lending to domestic non-banks ³	+ 2.9	+ 2.7	+ 0.0	- 1.2	+ 1.7	+ 2.1
	Percentage changes from previous year					
Inflation rate						
National	1.9	3.3	2.4	2.0	1.8	1.8
Harmonised	1.7	3.6	2.6	2.1	1.7	1.8
Core inflation ⁴	1.2	2.8	2.3	2.3	2.0	1.9

Source: WIFO. 2014, 2015: forecast. – 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.

Table 5: Earnings and international competitiveness

	2010	2011	2012	2013	2014	2015
	Percentage changes from previous year					
Gross earnings per employee ¹	+ 0.9	+ 1.8	+ 2.4	+ 2.1	+ 1.9	+ 2.5
Gross real earnings per employee ²	- 0.9	- 1.4	- 0.1	+ 0.1	+ 0.1	+ 0.7
Net real earnings per employee ²	- 1.1	- 1.8	- 1.1	- 0.3	- 0.3	+ 0.1
Unit labour costs						
Total economy	- 0.0	+ 0.8	+ 3.0	+ 2.5	+ 1.5	+ 1.7
Manufacturing	- 6.9	- 3.0	+ 3.0	+ 1.9	- 0.3	- 1.1
Effective exchange rate, manufactures						
Nominal	- 2.9	+ 0.1	- 1.7	+ 1.8	+ 1.2	+ 0.2
Real	- 3.2	+ 0.5	- 1.7	+ 2.1	+ 1.5	± 0.0

Source: WIFO. 2014, 2015: forecast. – ¹ Employees according to National Accounts definition. – ² Deflated by CPI.

2.5 Labour supply growth remains buoyant

Employment growth lost some momentum in the last few months. Despite weak business activity, the number of persons in dependent active employment went up by 0.6 percent on annual average 2013. Even with the cyclical upturn gaining ground in 2014 and 2015, overall job growth is expected to stay moderate, at a rate of 0.9 percent respectively.

Despite the increase in employment, unemployment will be further driven up by the strong expansion of labour supply. After an increase by 0.6 percentage points to a rate of 7.6 percent of the dependent labour force in 2013, the jobless rate (on national definitions) will climb to 8.1 percent in 2014 and 8.3 percent in 2015. According to Eurostat definitions, the unemployment rate averaged 4.9 percent in 2013 and is forecasted to move up to 5.2 percent in 2014 and 5.3 percent in 2015.

Labour market developments are set to stay uneven: sustained employment growth will go along with rising unemployment over the entire forecast period.

Table 6: Labour market

		2010	2011	2012	2013	2014	2015
		Changes from previous year, in 1,000					
<i>Demand for labour</i>							
Persons in active employment ¹		+ 37.4	+ 67.3	+ 51.7	+ 30.3	+ 35.0	+ 35.0
Employees ²		+ 25.5	+ 63.3	+ 47.2	+ 21.2	+ 29.0	+ 30.0
Percentage changes from previous year		+ 0.8	+ 1.9	+ 1.4	+ 0.6	+ 0.9	+ 0.9
Nationals		+ 5.8	+ 25.7	+ 9.0	- 8.5	+ 1.0	+ 1.0
Foreign workers		+ 19.7	+ 37.7	+ 38.1	+ 29.7	+ 28.0	+ 29.0
Self-employed ³		+ 11.9	+ 4.0	+ 4.5	+ 9.1	+ 6.0	+ 5.0
<i>Labour supply</i>							
Population of working age	15 to 64 years	+ 17.3	+ 31.3	+ 18.0	+ 23.5	+ 5.8	+ 8.1
	15 to 59 years	+ 4.9	+ 11.7	+ 22.3	+ 27.2	+ 5.6	+ 1.7
Labour force ⁴		+ 27.9	+ 63.2	+ 65.6	+ 56.9	+ 59.0	+ 45.0
<i>Surplus of labour</i>							
Registered unemployed ⁵		- 9.5	- 4.1	+ 13.9	+ 26.6	+ 24.0	+ 10.0
In 1,000		250.8	246.7	260.6	287.2	311.2	321.2
Unemployed persons in training ⁵		73.2	63.2	66.6	73.5	79.5	82.5
		In percent					
Unemployment rate							
Eurostat definition ⁶		4.4	4.2	4.3	4.9	5.2	5.3
As a percentage of total labour force ⁵		6.2	6.0	6.3	6.8	7.3	7.4
National definition ^{5,7}		6.9	6.7	7.0	7.6	8.1	8.3
Employment rate							
Persons in active employment ^{1,8}		65.4	66.2	66.9	67.2	67.7	68.3
Total employment ^{6,8}		71.7	72.1	72.5	72.3	72.7	73.1

Source: WIFO. 2014, 2015: forecast. – ¹ Excluding parental leave, 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 As a percentage of total labour force, excluding self-employed. – ⁸ As a percentage of population of working age (15 to 64 years).

2.6 Inflation dynamics subdued

The momentum of inflation is likely to remain moderate over the forecast horizon. The terms-of-trade should improve slightly, keeping the GDP deflator firmly under control with a moderate rise. At the consumer level, major upward pressure is expected to originate from price hikes for processed food and services in both years. Energy prices should still have a dampening impact on the consumer price index in 2014. Overall, WIFO projects headline inflation at 1.8 percent each for 2014 and 2015.

The hikes in consumption taxes as from March 2014 (for tobacco, sparkling wine, alcohol, car registration and car insurance) will add around ¼ percentage point to the annual increase in the consumer price index for 2014³. A further increase in the tobacco tax planned for April 2015 and higher rents for price-regulated dwellings⁴ as of April 2014 are estimated to push up the inflation rate by some 0.2 percentage points for 2015.

On the basis of the HCPI, annual inflation is projected at 1.7 percent for 2014 and 1.8 percent for 2015. Despite the overall moderate pace by past standards, inflation pressure in Austria significantly exceeds the euro area average. Thus, in its projection of June 2014, the ECB anticipates euro-area inflation, as measured by the HCPI, at 0.7 percent and 1.1 percent for 2014 and 2015, respectively. A major factor explaining the differential is the stronger increase in services prices in Austria.

³ According to the Harmonised Consumer Price Index (HCPI), the tax increases will raise the index by only 0.1 percentage point, since the engine-size-based car insurance tax is not included in the HCPI basket.

⁴ According to WIFO estimates, this concerns about one-third of the stock of rented apartments in Austria; for reasons of data collection and processing, these rent hikes will enter the Consumer Price Index with a lag of about six months, largely impacting on the annual inflation rate only in 2015.

2.7 Government balance shaped by consolidation and bank support measures

The general government balance (in the Maastricht definition) will be shaped in 2014 and 2015 by consolidation measures on the one hand, and by one-off expenditure for the liquidation of Hypo Alpe-Adria-Bank AG, on the other. For 2014, WIFO projects a general government deficit of 2.8 percent of nominal GDP, for 2015 a deficit ratio of 1.7 percent. Outlays for bank support are expected at € 4.4 billion for 2014 and € 1.0 billion for 2015 (including the "bad bank"), which will increase the deficit accordingly. In 2014, one-off revenues of around € 0.5 billion will accrue from the tax agreement with Liechtenstein. The structural deficit will amount to 1.1 percent of GDP in 2014 and edge down marginally to 1.0 percent of GDP in 2015.

Fiscal policy will be governed over the projection horizon by large-scale consolidation efforts.

Table 7: Key policy indicators

	2010	2011	2012	2013	2014	2015
	As a percentage of GDP					
<i>Fiscal policy</i>						
General government financial balance						
According to Maastricht definition	- 4.5	- 2.5	- 2.6	- 1.5	- 2.8	- 1.7
Structural budget balance	- 3.2	- 2.4	- 1.8	- 1.2	- 1.1	- 1.0
General government primary balance	- 1.8	+ 0.2	+ 0.0	+ 1.0	- 0.2	+ 0.9
	In percent					
<i>Monetary policy</i>						
3-month interest rate	0.8	1.4	0.6	0.2	0.3	0.2
Long-term interest rate ²	3.2	3.3	2.4	2.0	1.7	1.9
	Percentage changes from previous year					
<i>Effective exchange rate</i>						
Nominal	- 2.7	+ 0.2	- 1.5	+ 1.7	+ 1.2	+ 0.2
Real	- 3.0	+ 0.6	- 1.6	+ 2.0	+ 1.5	± 0.0

Source: WIFO. 2014, 2015: forecast. - ¹ 10-year central government bonds (benchmark).

The Tax Revenue Amendment Act ("Abgabenänderungsgesetz") provides € 0.7 billion for 2014 and some € 1.1 billion for 2015 for additional structural revenues. On the expenditure side, the budgetary path foresees savings mainly in the area of retirement benefits and discretionary outlays (not determined by legal commitments). Should the measures underlying the present forecast not take their full effect, the deficits for 2014 and 2015 will turn out higher by the amount of slippage. Particular expenditure risks derive from the still not quantifiable transfers required for the distressed banks that were nationalised in the course of the crisis.

3. The risk environment

The margin of uncertainty surrounding the forecast remains high and difficult to ascertain. The major risks relate to the international economic and policy environment. Thus, further action to resolve the debt crisis in a number of countries and the appropriate policy reaction at the European level are a matter of concern. In this regard, the banking sector in the euro area is facing important challenges. During summer and autumn 2014 banks will be subjected to comprehensive stress tests in order to identify potential capital requirements. Should a number of banks be found to lack sufficient equity capital and thus require financial support from the government, it would severely strain the already tight fiscal scope of the member countries concerned. Apart from such economic challenges, geo-political tensions in Austria's eastern neighbourhood further add to forecast risks. If these risks were to turn out unexpectedly high, private households, firms and financial investors may relapse into a new bout of pessimism, undermining the tentative cyclical recovery in Europe.

Likewise, a generalised fall in the price level may inhibit the recovery in the euro area. A period of deflation is tantamount to an increase in real interest rates and in the real value of debt. Against the backdrop of very low and further declining inflation rates in the euro area, the European Central Bank has taken expansionary action for some time. Although the euro area as a whole is still a good deal away from

a self-reinforcing deflation of prices and wages, the inflation rate is barely positive or already slightly negative in a few countries. A slip of these countries into a period of sustained deflation would surely complicate their return to a stable growth path. On the other hand, the dangers emanating from over-extended monetary expansion should not be underrated. Thus, the accumulation of (medium-term) risks in the financial sector as a result of exaggerated monetary easing is a key issue especially for a monetary union. In this respect, the further expansionary stance of monetary policy ought to be supplemented by country-specific macro-prudential action⁵ in order to prevent financial imbalances from building up in countries exhibiting uneven financial market cycles.

Risks for the global economy derive from a number of potential geo-political tensions as well as from the generally weak growth impulses coming from the emerging market economies. These factors represent downward risks for the Austrian economy from the external side. Domestic opportunities and risks for growth are mainly related to developments on the labour market. On the one hand, the benign employment situation and robust income growth may boost private consumption beyond expectations. Greater confidence would, in this case, discourage consumers from stepping up precautionary saving, leading to a further boost of consumption. On the other hand, investment is expected to recover from its longer-lasting decline, moving to a but moderate pace of expansion. Should, however, private consumption and exports prove more buoyant than anticipated, investment behaviour may also hold an upward risk to the present forecast.

⁵ Instruments of macro-prudential intervention into operative business may be put into two categories: first, policy instruments influencing the decisions of lenders (e.g., equity capital requirements varying over the business cycle, flexible debt ceilings, possibility to increase the weights of risk for specific assets, dynamic arrangements for credit risk provision, liquidity indicators to support stable refinancing sources etc.); and second, instruments for influencing the decisions of potential debtors (e.g., varying requirement for credit securities, liquidity indicators to support debt sustainability, loan-to-value ratio, debt-to-income ratio, loan-to-income ratio, etc.).

Alternatively, macro-prudential measures may be classified by the kind of systemic risk that are to be addressed by the intervention (instruments designed to limit systemic risks over time or across countries).