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Economic Growth Stable

Against the background of global economic revival, Austria's economy expanded at a robust pace of 0.6 percent (in real terms, seasonally adjusted) from the previous period in the first quarter. Industry and exports are exhibiting strong momentum; signs for an upturn in investment are increasing. Private consumption has turned more stable.

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Robust global economic activity accelerated growth also in the euro area. Compared with the previous quarter, real GDP rose at a seasonally adjusted rate of 0.6 percent in the first quarter, up from +0.3 percent in the fourth quarter of 2005. Private demand posted particularly strong gains. Looking further ahead in the year, sentiment continues to be optimistic, with consumer and industrial confidence surveys conducted by the European Commission showing a clear upward trend since mid-2005. The business climate index, despite having declined somewhat in May, was at a historic high.

According to the revised quarterly calculation by WIFO, the Austrian economy expanded by 0.6 percent in volume (seasonally and working-day adjusted) in the first quarter compared with the previous period, after +0.7 percent in the fourth quarter. The year-on-year growth rate was 3 percent, however with two more working days than (in the same period) in 2005. Manufacturing again provided strong stimulus (+0.9 percent quarter-on-quarter), albeit somewhat weaker than in the previous period (+1.3 percent in real terms). The first quarter saw export activity gathering considerable momentum: total exports (goods and services) picked up sharply quarter-on-quarter (+1.8 percent in real terms, up from +1.3 percent in the fourth quarter), with notably goods exports posting vigorous gains (+1.9 percent). Total imports also expanded significantly (+1.7 percent). In contrast, real growth of private consumption hardly accelerated at all and at 0.5 percent was unchanged from the previous four quarters. Compared to the same period a year earlier, however, the growth rate rose to 2.0 percent. Investment activity developed favourably: while gross investment in fixed assets increased by 0.9 percent in real terms quarter-on-quarter, following below-trend growth in the preceding quarters, the demand for investment in equipment moved up 0.7 percent.

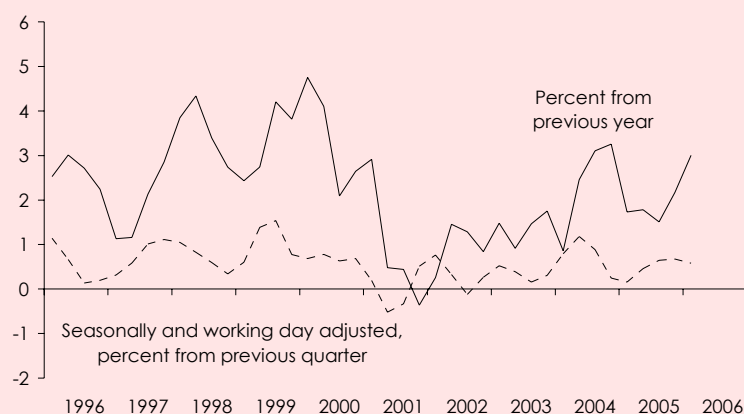
Evidence from WIFO's May business cycle survey increasingly suggests a further pick-up in economic activity, with manufacturers reporting order books hitting record levels unseen since the year 2000.

Oil prices remain high and volatile owing to the rising demand by Asian countries and supply shortages prompted by political uncertainties. Fuelled by a renewed surge in housing and energy costs, the rate of inflation in Austria was 1.7 percent in April, significantly higher than in the preceding months.

The economic recovery supported gains in employment and job vacancies, with the number of unemployed dropping to 211,850 in May (down by 11,500 year-on-year); the number of persons enrolled in training programmes increased. The unemployment rate stood at 7.0 percent (seasonally adjusted) according to the national definition, or 4.9 percent according to Eurostat.

Figure 1: Growth of real GDP

Percentage changes from previous period



Source: WIFO

The global economy continues to be buoyant. The Ifo indicator for the world economic climate improved in the second quarter of 2006 for the third time in succession, rising from 109.2 to 111.0 points. In the three major regions of the world economy, North America, Asia and Western Europe, expectations for the future are highly optimistic.

After a minor slowdown in late 2005, US economic growth picked up speed again in the first quarter of 2006, rising at a seasonally adjusted rate of 1.3 percent in volume from the previous period. Consumption expenditure of private households, notably on durable goods, rose markedly early in the year (+4.8 percent quarter-on-quarter), and with +0.9 percentage point again provided the biggest contribution to GDP growth. Exports also gathered considerable momentum, increasing by 3.5 percent in volume quarter-on-quarter. The external sector's contribution to growth continues to be negative, with buoyant domestic demand being reflected in a pull of imports. In 2005, the current account deficit was around 7.0 percent of US nominal GDP. The foreign trade imbalance of the United States continues to pose a risk to global economic activity.

If consumer spending in the USA should weaken, the recent pickup in export activity fuelled by a weaker dollar may counteract a downturn in economic growth. Such a slowdown in private consumption could be prompted by losses in real household disposable income due to persistently high fuel prices. The negative saving ratio may also affect future household spending. The Conference Board Consumer Confidence Index fell markedly in May from the high level a month before. While sales of new or used homes in the USA have slowed considerably since the beginning of 2006 compared with last year, residential permits issue and the construction of residential housing also followed a downward trend in March and April. This could be the first sign of a cooling of the real estate boom, in the past a driver of consumer spending.

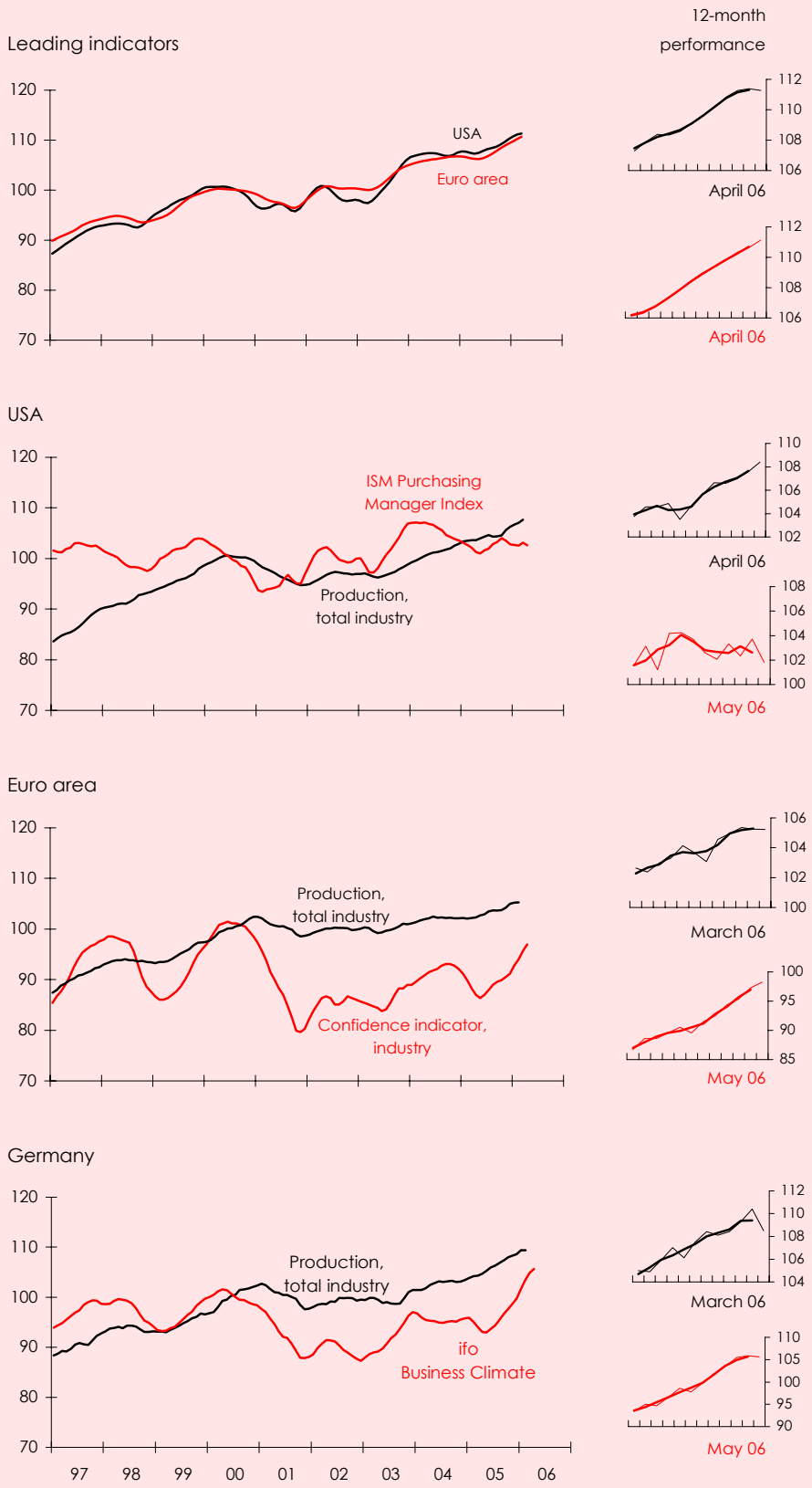
The economies of China and India continue to expand at a vigorous pace, with both countries contributing an ever-increasing share to persistent global economic growth. Japan appears to have set off on a stable upward trend; apart from exports to the emerging economies of Asia, private consumption as well as investment has begun to contribute positively to growth. However, first quarter 2006 saw a deceleration of overall economic growth to a rate of 0.5 percent (in real terms, seasonally adjusted, quarter-on-quarter).

Global economy remains buoyant

Economic activity in the United States picked up speed again in the first quarter. Nevertheless, evidence of a slackening in household spending is mounting.

Figure 2: International business climate

Seasonally adjusted, 2000 = 100, 3-month moving average



Source: European Commission, Deutsche Bundesbank, ISM (Institute for Supply Management™), ifo (Institute for Economic Research, Munich), OECD.

After a temporary dip in the last quarter of 2005, the euro area economy showed new vigour in the first quarter of 2006, with seasonally adjusted real GDP advancing 0.6 percent compared with the previous period, up from +0.3 percent in the last quarter of 2005. The rate of growth for the EU-25 was 0.7 percent. Private household demand increased significantly, moving up 0.7 percent in real terms in the euro area.

Following stagnation in late 2005, the German economy again developed much more favourably in the first quarter of 2006. Real GDP rose at a seasonally adjusted rate of 0.4 percent quarter-on-quarter, with very lively external trade driving the expansion. The decline in unit labour costs has enabled German exporters to increase their market shares. Domestic demand, on the other hand, continues to contribute only little to economic growth. In Italy, Austria's second-most important trade partner, a rebound appears to be under way, with the economy stabilising and for the first time in a long time beginning to react again to the good performance of the world economy: In the first quarter, real GDP grew at a seasonally adjusted rate of 0.6 percent quarter-on-quarter. Industrial production has picked up again, following the unfavourable developments of last year, and imports and exports are gathering momentum.

In the EU, the assessment of the current economic development is generally positive, with the results of business surveys in recent months climbing to their highest levels since 2001. In the euro area, the Industrial Confidence Indicator improved for the sixth time in a row, and the European Commission's Business Climate Index, despite falling somewhat in May, remains very high. The assessment of the outlook for industrial production continues to be highly optimistic. Capacity utilisation in the manufacturing sector, which last year had been below trend, was raised to 82 percent in the first quarter and is thus approaching its level in the past. This suggests investment may be picking up again. The assessment of the current situation in the services and retail sectors is much more favourable than its long-term average. Consumer confidence has also improved, mainly in response to increased optimism regarding labour market conditions. May saw a slight darkening of the improved sentiment observed in Germany in recent months, with both the Ifo Business Climate Index and the ZEW Indicator of Economic Sentiment falling moderately. The high euro exchange rate may have an adverse effect on Germany's export industry, its main driver of economic growth.

Euro area inflation accelerated further to a pace of 2.5 percent, up from 2.4 percent in April, according to Eurostat's estimates. As had been expected, the ECB raised the key interest rate from 2.5 percent to 2.75 percent in June, the third increase in six months.

In mid-May, the European Commission gave a positive appraisal of Slovenia's application for membership of the European Monetary Union, the country is expected to adopt the common currency in January 2007.

Oil prices were very volatile in the first months of 2006 and stayed high in late May, in reaction both to demand developments – Asia's continuously rising demand for energy – and supply shortages. Oil production in the Gulf of Mexico is still below the levels seen before hurricane "Katrina". Persistent political unrest in Iraq and Nigeria are also weighing on production. The negative effects of this price surge on the economies of the oil-importing countries are counteracted by their growing international entwinement: The revenues of oil-exporting countries flow back into the international economic system ("recycling of petrodollars"), their deposits in capital markets keep the level of interest rates low internationally, their imports from Europe have been rising in recent months. In addition, the intensification of trade with low-cost producing countries such as China lowers production costs in Europe, thus curbing impending inflation.

Gold, silver and copper prices have tumbled sharply in recent months. Whether this decline is just of a short-term nature or signals the end of the commodities boom of recent years cannot be predicted at the present juncture. The Vienna Stock Ex-

EU Economic growth accelerating

The first quarter saw a pickup in economic activity in Europe. Leading indicators point to robust expansion.

Oil price boom continues

Oil prices remain high; they are driven by supply shortages and increased demand.

change, like other stock exchanges throughout the world, also suffered major temporary falls in share prices in May.

In the first quarter of 2006, the Austrian economy grew at a seasonally and working-day adjusted rate of 0.6 percent in real terms from the previous period, down from 0.7 percent in the fourth quarter of 2005. Due to the calendar effect of 2 more working days in the first quarter of this year compared with last year, the year-on-year rate of growth was as high as 3 percent. Industrial activity continues to be lively, with manufacturing at +0.9 percent recording the highest quarter-on-quarter increase in value added among all economic sectors. The rate of growth in construction was 0.5 percent, equivalent to the average pace in recent quarters. Developments in the trade sector have been disappointing, with only moderate quarter-on-quarter growth of 0.2 percent, contrasting with +3.2 percent on a year-on-year basis, however.

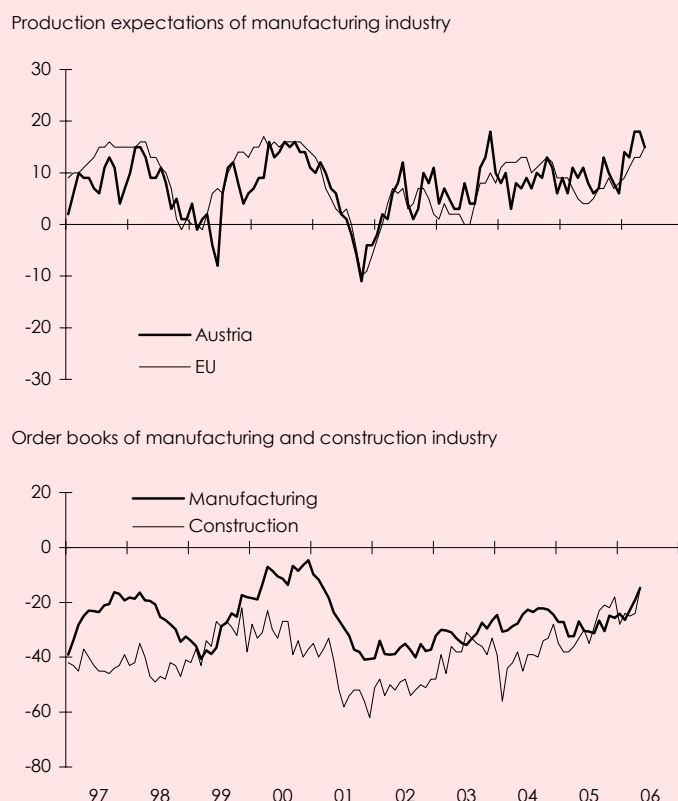
Export activity in the first quarter was almost as strong as during 2004: Exports of goods expanded by 12.3 percent in real terms year-on-year, according to the latest reading of the National Accounts, outpacing growth in the previous period by 1.9 percent (seasonally adjusted). Expansion in this sector is broadly based: While the major part of exports of goods still goes to the EU-15, exports to the 10 new EU member states have also been raised (+18 percent from January to March, according to the Foreign Trade Statistics). Austria's most important trade partners in this region are Hungary, the Czech Republic, Poland and Slovenia.

Austrian economy expanding

In the first quarter of 2006, the Austrian economy grew by 0.6 percent in volume quarter-on-quarter. Manufacturing expanded vigorously thanks to lively export activity.

Figure 3: WIFO business cycle survey

Differences between the percentage shares of firms giving positive and negative replies, seasonally adjusted



Source: European Commission, WIFO business cycle survey.

Imports of goods in the period from January to March outpaced the year-earlier level by 13.4 percent in nominal terms, according to the National Accounts. This strong increase can be largely attributed to the substantial rise in import prices; in real terms, imports rose by 8.9 percent. The readings of the rates of change in both

exports and imports are based on the preliminary Foreign Trade Statistics data and might be overestimated.

The results of WIFO's monthly business survey suggest that this upward trend is continuing. Sentiment among the surveyed firms in manufacturing and construction was found to be optimistic, with the assessment of order books in manufacturing climbing to a record high in May. The number of firms in construction describing their order books as satisfactory has also risen, with notably building construction reporting extremely good figures. The suppliers of motor vehicle components anticipate an increase in production. Advance purchases of durable goods in Germany ahead of the VAT increase are likely to play a role here. The rise in the working-day adjusted production index (excluding energy) by 4.4 percent in March supported the assessment in the WIFO business survey. The BA-CA Purchasing Managers' Index reached its highest level in six years and fell somewhat at the end of May.

Private consumption growth is an essential precondition for a solid economic upswing. Austria is currently experiencing a continuous rise in consumer demand. While there is hardly any indication of an upward trend on a seasonally adjusted quarter-on-quarter basis (with growth at around +0.5 percent in the last four quarters remaining largely constant), the year-on-year rate of growth has risen to 2.0 percent. Gains posted in recent months by the consumer confidence indicator – the proportion of households viewing their future financial situation as favourable has risen markedly – could signal an acceleration in consumption growth over the near term. Likewise, the assessment by consumers of the general economic situation has brightened steadily over recent months. The demand for durable goods responsive to cyclical trends registered above-trend growth in the first quarter (+3.5 percent year-on-year).

Healthy corporate profits and improved sales expectations in manufacturing are a good basis for a revival of investment. Gains in wholesale sales of capital goods in recent months also suggest a pickup in investment activity. In the first quarter, business spending on equipment advanced at a rate of 6.0 percent in volume year-on-year. As the major part of capital goods is imported, the accumulated increase in imports of machinery in the first two months of the year was 7.9 percent, much higher than last year.

In the 2005-06 winter season, tourism sales expanded by 2.7 percent in nominal terms to € 9.32 billion, according to preliminary calculations. This result is to a large degree attributable to above-trend gains in April, which were substantially higher than expected, as a counter-movement to the strong decline in March (due to Easter falling in April this year).

In the six months of the past winter season, the total number of overnight stays outpaced the year-earlier level by 1.3 percent, with those by resident visitors rising at twice that pace. The demand from foreign guests, at +0.9 percent, was rather subdued. Looking at the markets of origin, the picture is quite diverse: While overnight stays by guests from France, Italy, Great Britain, Belgium and the Netherlands posted some vigorous gains, the demand from Swiss guests expanded at only a moderate pace, and that from visitors from Germany and the United States declined.

Tourism sales increased substantially in Burgenland, Vienna, Lower Austria, Carinthia, Styria and Salzburg, were rather weak in Upper Austria, and were flat in Tyrol and Vorarlberg compared with last year's results.

Consumer demand beginning to stabilise

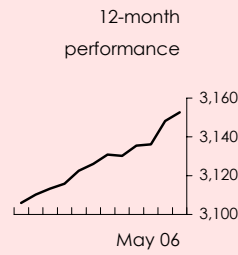
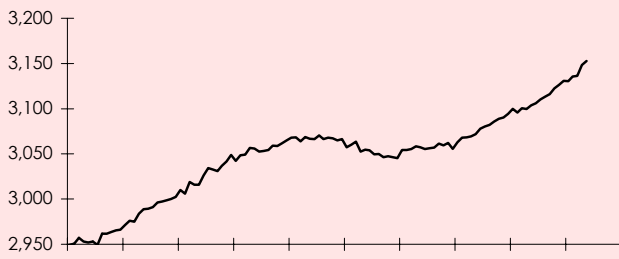
First signs of investment revival

Investment activity may get into gear thanks to the expansion in manufacturing.

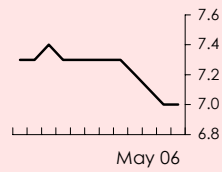
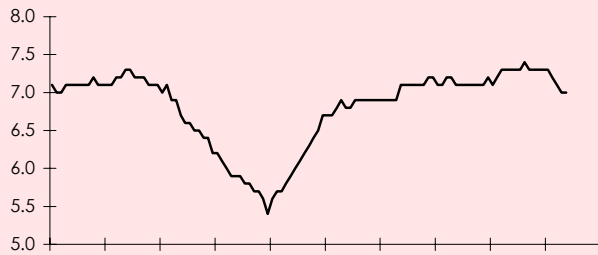
Higher sales recorded for winter tourist season

Figure 4: Key economic indicators

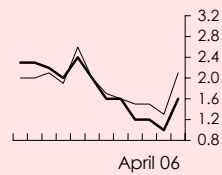
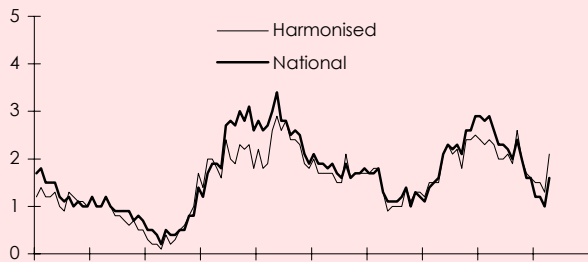
Persons in active dependent employment¹, (1,000³), seasonally adjusted



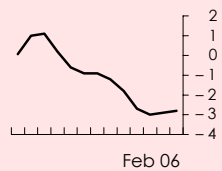
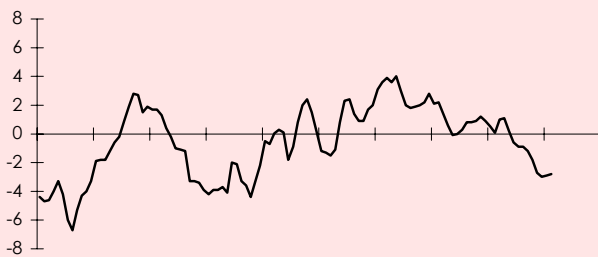
Unemployment rate, traditional Austrian method², seasonally adjusted



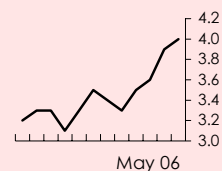
Consumer prices, year-to-year percentage changes



Real effective exchange rate, year-to-year percentage changes



10-year central government bonds (benchmark), percent



Source: Austrian Labour Market Service, Federation of Austrian Social Security Institutions, Oesterreichische Nationalbank, Statistics Austria, WIFO calculations. – ¹ Excluding parental leave, military service, and unemployed persons in training. – ² As a percentage of total labour force excluding self employed, according to Labour Market Service.

In April, inflation at 1.7 percent was higher than in the first quarter of 2006 (1.0 percent in March and 1.2 percent both in January and February), reverting to its level in late 2005. Higher energy prices and housing costs continued to account for almost half of the inflation rate, with notably prices of household energy, housing rents and running costs rising markedly. The energy-relevant "Transport" group also registered sizeable month-on-month price increases in April, whereas prices continued to decline in the main group of "Communications". While the Harmonised Consumer Price Index (HCPI) at +2.1 percent in April rose more strongly than the CPI according to the Austrian method of calculation, inflation continued to be lower than in the euro-zone, where it stood at 2.4 percent in April.

The pass-through of higher energy prices to wages and producer prices is likely to be limited due to only a modest rise in demand. Industrial producer price inflation, at an annual rate of 2.4 percent, remained stable in the first quarter.

Robust economic expansion has recently allowed an increase in employment numbers (+50,500 in May, or +1.6 percent year-on-year). While last year employment gains were largely limited to part-time jobs, recent months have also seen first increases in full-time jobs. The upward trend observed in construction since mid-2005 has continued despite unfavourable weather conditions at the beginning of the year. The rate of job cuts in manufacturing has decelerated further (-1,800 in April), while new jobs have once more been added in the heterogeneous business services sector. The economic recovery is also reflected in the higher number of vacancies registered with the AMS (Labour Market Service) (+5,324).

In May, 211,850 people were registered as unemployed with the Labour Market Service, a decline by 11,500 from a year earlier. The funds for active labour market policy measures were raised at the beginning of the year, allowing also an expansion of training programmes: 62,600 people were enrolled in training courses last month (+11,100 compared with last year); they are not included in the official unemployment statistics. The seasonally adjusted unemployment rate stood at 7 percent according to the national definition, or at 4.9 percent according to Eurostat.

Inflation accelerating at low level

Inflation in April stood at 1.7 percent, markedly higher than in previous months. The main upward contribution came from higher energy prices and housing costs.

Employment improving further