WIFO ■ BULLETIN

No. 9/2015
June 2015

Christian Glocker

Uncertainty Weighing on Business Activity

Economic Outlook for 2015 and 2016

Uncertainty Weighing on Business Activity. Economic Outlook for 2015 and 2016
After the slow pace recorded in 2014, growth of the Austrian economy is likely to remain modest also in early 2015. Leading indicators to date give no substantial hint for a revival of business activity. Hence, the conditions for a cyclical recovery during the first half of the year are hardly in place. More favourable developments may set in only in 2016. Apart from a rebound in global demand and output, the weak euro exchange rate and low commodity prices should give positive incentives to the domestic economy. GDP growth is expected to gradually pick up from 0.3 percent in 2014 to 0.5 percent in 2015 and 1.3 percent in 2016.

Contact:

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

JEL codes: E32, E66 • **Keywords:** Business Cycle, Economic Outlook, Forecast

For definitions of terms used, see "Methodological Notes and Short Glossary", http://www.wifo.ac.at/wwadocs/form/WIFO-BusinessCycleInformation-Glossary.pdf • All staff members of the Austrian Institute of Economic Research contribute to the Economic Outlook. • Cut-off date: 19 March 2015.

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

ISSN 1605-4709 • © Austrian Institute of Economic Research 2015
Impressum: Herausgeber: Karl Aiginger • Chefredakteur: Michael Böheim (Michael.Boeheim@wifo.ac.at) • Redaktionsteam: Tamara Fellinger, Ilse Schulz, Tatjana Weber • Medieninhaber (Verleger) und Redaktion: Österreichisches Institut für Wirtschaftsforschung • 1030 Wien, Arsenal, Objekt 20 • Tel. (+43 1) 798 26 01-0 • Fax (+43 1) 798 93 86 • http://bulletin.wifo.ac.at • Verlags- und Herstellungsort: Wien

Economic activity in Austria lost momentum in the third and fourth quarter 2014 and growth has virtually come to a halt. At present, positive incentives are lacking both from domestic and foreign demand. Developments in the fourth quarter 2014 were marked by sluggish domestic demand and exports as well as by declining output in manufacturing and construction. Low order levels, coupled with receding final domestic and foreign demand and weak economic confidence prompt firms to hold back with investment. Leading indicators do not signal a rebound of activity for the next few months, rather have they been pointing down lately. Most evidence suggests that in spring 2015 the Austrian economy will remain in the quasi-stagnation observed in the preceding quarters. There are, on the other hand, no signs for the economy slipping into recession, although demand and output are vulnerable to further setbacks. Against this background, GDP growth in 2015 will be subdued like in 2014, extending the phase of weakness that started in 2012. Despite an expected pick-up of activity in 2016, production capacities will remain far from being fully utilised. The output gap will not be closed by the forecast horizon.

Despite the slight acceleration of growth over the forecast period, inflationary pressure should abate somewhat. After an increase by 1.7 percent in 2014, the consumer price index is projected to climb by 1.3 percent in 2015 and 1.5 percent in 2016. Besides private consumption, corporate investment will gradually head up. The external sector is unlikely to provide a positive net contribution to GDP growth over the forecast period. While the growth outlook for Austria's export markets has brightened in the last months, a sustained improvement should not be expected in view of market share losses and an unfavourable export structure.

Despite its slow pace, Austria's GDP growth is relatively labour-intensive, mainly due to a decline in average work hours. After an increase in the number of persons in dependent active employment by 0.7 percent in 2014, WIFO expects further gains of 0.5 percent and 0.7 percent in 2015 and 2016, respectively. Job creation is primarily driven by the service sector. However, given the strong expansion of labour supply, unemployment will continue heading up over the forecast horizon. After an increase in the jobless rate (national definition) by 0.8 percentage point to 8.4 percent in 2014, WIFO expects for 2015 a rate of 9.1 percent, rising further to 9.4 percent in 2016. The figures are nevertheless biased upwards by the parallel decline in the number of persons enrolled in training programmes organised by the labour market service.

Table 1: Main results

		2011	2012	2013	2014	2015	2016
				Percentage changes from previous year			
GDP							
Volume		+ 3.1	+ 0.9	+ 0.2	+ 0.3	+ 0.5	+ 1.3
Value		+ 4.9	+ 2.8	+ 1.7	+ 2.0	+ 1.9	+ 2.7
Manufacturing[1], volume		+ 9.0	+ 1.1	+ 0.6	+ 0.2	+ 1.0	+ 2.5
Wholesale and retail trade, volume		+ 3.6	− 0.1	− 1.6	− 0.8	± 0.0	+ 0.8
Private consumption expenditure, volume		+ 0.7	+ 0.6	− 0.1	+ 0.2	+ 0.4	+ 0.9
Gross fixed investment, volume		+ 6.8	+ 0.5	− 1.5	+ 0.5	+ 1.0	+ 1.5
Machinery and equipment[2]		+ 9.8	− 0.6	− 1.5	+ 1.5	+ 1.5	+ 2.5
Construction		+ 2.6	+ 1.2	− 2.2	+ 0.4	+ 0.5	+ 1.0
Other investment[3]		+ 12.9	+ 0.5	+ 0.3	− 1.2	+ 1.5	+ 1.2
Exports of goods[4]							
Volume		+ 7.1	+ 0.6	+ 2.8	+ 2.1	+ 2.5	+ 4.0
Value		+ 11.3	+ 1.5	+ 1.8	+ 1.7	+ 1.5	+ 4.7
Imports of goods[4]							
Volume		+ 8.3	− 0.9	+ 0.2	+ 0.9	+ 2.2	+ 3.3
Value		+ 15.3	+ 0.7	− 1.0	− 0.8	+ 0.7	+ 4.3
Current balance	billion €	+ 5.06	+ 4.73	+ 3.32	+ 4.45	+ 4.79	+ 3.31
As a percentage of GDP		+ 1.6	+ 1.5	+ 1.0	+ 1.4	+ 1.4	+ 1.0
Long-term interest rate[5]	percent	3.3	2.4	2.0	1.5	0.5	0.5
Consumer prices		+ 3.3	+ 2.4	+ 2.0	+ 1.7	+ 1.3	+ 1.5
Unemployment rate							
Eurostat definition[6]	percent	4.2	4.3	4.9	5.0	5.3	5.3
National definition[7]	percent	6.7	7.0	7.6	8.4	9.1	9.4
Persons in active dependent employment[8]		+ 1.9	+ 1.4	+ 0.6	+ 0.7	+ 0.5	+ 0.7
General government financial balance according to Maastricht definition							
As a percentage of GDP		− 2.6	− 2.3	− 1.5	− 2.8	− 2.2	− 1.9

Source: WIFO. 2015 to 2016: forecast. – [1] Value added, including mining and quarrying. – [2] Including weapon systems. – [3] Intellectual property products and cultivated biological resources. – [4] According to Statistics Austria. – [5] 10-year central government bonds (benchmark). – [6] According to Eurostat Labour Force Survey. – [7] According to Public Employment Service Austria, as a percentage of total labour force excluding self employed. – [8] Excluding parental leave, military service.

In spite of sluggish economic activity, public finances are unlikely to weaken further this year and next. The general government deficit (according to Maastricht definition) is expected to narrow from 2.8 percent of GDP in 2014 to 2.2 percent in 2015 and 1.9 percent of GDP in 2016. Under the present assumptions on the cyclical profile and the economic policy settings and conditions, a balanced general government budget will not be achieved either in nominal or in structural terms even by the end of the forecast horizon.

1. The starting situation

The Austrian economy remains caught in cyclical weakness affecting the major components of aggregate demand, although employment is growing while average working hours decline. Demand and output in 2014 remained broadly flat at a low level, adding a third year to the current period of sluggish activity. According to preliminary estimates, real GDP edged up by 0.3 percent in 2014 from the previous year, after +0.2 percent in 2013. Unlike in Germany and on average in the euro area, demand and output headed down in the second half of 2014.

Demand and output in Austria have most recently been lacking incentives from the domestic side as well as from abroad. Private consumption is flat and export growth is sluggish, with deliveries to several key regions like the euro area stagnating. The combination of weak order inflows, lacklustre domestic and foreign final demand and a gloomy business climate prompts firms to hold back with investment.

On the demand side, results for the fourth quarter 2014 were dampened by weak private consumption and firms' restraint on investment. Most significant was the fall in transport equipment purchases. Gross fixed capital formation has been heading increasingly downwards for almost one year. The adverse external environment is undermining the production of goods in Austria. Against this background, exports have maintained a, though only moderate, upward trend. More buoyant gains have last been recorded in the first quarter 2014. Imports receded markedly in the second half of 2014, due to anaemic final domestic demand. External trade therefore contributed at face value positively to GDP growth in the fourth quarter, but for the whole year 2014 the external growth contribution was negative.

On the output side of GDP, the performance was uneven across economic sectors. Given the moderate export growth, activity in the export-oriented industry slackened in the fourth quarter, manufacturing gross value added fell markedly from the previous period. For the whole year 2014, the manufacturing sector posted a small gain. Within the service sector, developments differed: while public administration and other business activities lent stable support to GDP growth, output fell partly substantially in the trade sector, financial and insurance activities as well as in information and communication services.

It was particularly domestic demand that performed much weaker than in Germany or on average in the euro area. While the growth contribution of public consumption was rather small in the euro area as a whole, in Germany and Austria, private household spending and net exports were, unlike in Austria, growth drivers in Germany and the euro area.

The cyclical sluggishness prevailing since 2012 in Austria has several reasons. On the one hand, lean real income gains leave little scope for higher private consumption expenditure. On the other hand, weak sales expectations cloud the outlook for the export-oriented sector. Uncertainty about future sales prospects domestically and abroad weigh on firms' appetite for investment. The tentative pick-up of gross fixed capital formation that started in late 2013 and early 2014 stalled thereafter as earlier highly optimistic expectations were disappointed and had to be revised down step by step. In view of stagnating order inflows, utilisation of production capacities did not rise to an extent warranting their enlargement.

2. External environment and policy settings

Business activity should strengthen somewhat over the forecast horizon.

Underlying the present forecast are a number of assumptions, notably on the development of interest rates, exchange rates, oil prices, world trade and economic policy settings. These assumptions highlight the conditional character that is typical for economic projections. The forecast horizon stretches from the first quarter 2015 to the fourth quarter 2016.

The global business cycle keeps being shaped by an overall tentative recovery. Divergence between the major regions of the world is large and has been growing in the last months: while the forces of expansion have strengthened in the USA, recovery has taken hold also in the euro area and Japan. Developments in the emerging market economies has been uneven, with the pace of growth being below-average overall. The oil price slump of the last weeks and months may provide welcome impetus to business activity in many oil-importing countries, even if the accompanying fall in the inflation rate in the euro area carries a latent risk of deflation.

In the USA, the cyclical recovery has meanwhile become self-sustained, the trend is clearly upward-bound and broad-based across the economy. Both private consumption and investment in machinery and equipment and construction contribute to GDP growth, not least because excessive private indebtedness has been unwound in recent years, offering greater leeway for additional consumer and investment spending. This should provide positive stimulus in the current zero-interest environment. Also the labour market is improving, with the jobless rate declining steadily. In such an environment, WIFO expects US GDP to advance by 2.9 percent in 2015 and 2.8 percent in 2016. Thanks to gains in real purchasing power and the gradual improvement of the labour market, private consumption will expand swiftly, even if it is uncertain whether the current pace can be maintained. However, a major retrenchment of investment in the oil and gas industry on the back of the low oil price level may put a brake on the growth momentum.

The cyclical recovery in the euro area firmed somewhat in the second half of 2014, and benign signals from leading indicators bode well for the trend remaining upward bound. In particular the depreciation of the euro and the implicit gradual pick-up in external demand should provide expansionary stimulus. The upswing should also receive support from domestic demand. Latest results from the bank lending survey in the euro area point to a relaxation of credit guidelines, which should spur private consumption and business investment. In addition, fiscal policy is likely to move towards a less restrictive stance. Yet, several growth-retarding factors are set to wear off only slowly: unlike for the corporate sector, deleveraging goes on for private households and in the public sector. Also, the fall in the investment ratio and the under-utilisation of production capacities, notably in the labour market, foreshadow a slowdown of the long-term growth potential. All in all, real GDP in the euro area is projected to expand by 1.1 percent in 2015 and 1.3 percent in 2016. Thanks to easing commodity prices and given the high, albeit receding unemployment, inflation will remain subdued.

During the past six months, the reference oil price (Brent) fell by about one-third from $ 100 per barrel to currently around $ 60. Unlike the transitory and much less significant decline in spring 2012 and in summer 2013, the latest slump is hardly caused by reduced demand prospects, but by a structural excess supply on oil markets (increase in non-OPEC oil production, notably in the USA). The price slump was triggered by the decision of Saudi-Arabia, to react in this situation by accepting lower prices rather than by cutting production, in order to reduce incentives for the often costly exploration of new supplies and to protect its market share in the long run.

Table 2: World economy

	2011	2012	2013	2014	2015	2016
	Percentage changes from previous year					
Real GDP						
World	+ 4.1	+ 3.4	+ 3.3	+ 3.3	+ 3.7	+ 3.7
USA	+ 1.6	+ 2.3	+ 2.2	+ 2.4	+ 2.9	+ 2.8
Japan	– 0.5	+ 1.8	+ 1.6	– 0.0	+ 0.8	+ 1.4
EU 28	+ 1.7	– 0.4	± 0.0	+ 1.4	+ 1.5	+ 1.7
Euro area 19	+ 1.6	– 0.7	– 0.5	+ 0.9	+ 1.1	+ 1.3
CEEC 5[1]	+ 3.3	+ 0.5	+ 1.0	+ 3.0	+ 2.7	+ 3.1
China	+ 9.3	+ 7.7	+ 7.8	+ 7.4	+ 7.0	+ 6.5
World trade, volume	+ 6.0	+ 2.1	+ 2.7	+ 3.3	+ 4.1	+ 4.2
Market growth[2]	+ 7.5	+ 0.8	+ 1.8	+ 3.0	+ 3.5	+ 4.0
Primary commodity prices[3]						
HWWI index, total	+ 28.6	– 2.8	– 1.9	– 7.0	– 24	+ 2
Excluding energy	+ 19.2	– 14.4	– 6.1	– 6.2	– 5	+ 10
Crude oil prices						
Brent, $ per barrel	111.3	111.6	108.7	99.0	70	80
Exchange rate						
$ per euro	1.392	1.286	1.328	1.329	1.15	1.15

Source: WIFO. 2015 to 2016: forecast. – [1] Czech Republic, Hungary, Poland, Slovakia, Slovenia. – [2] Real import growth of goods of trading partners weighted by Austrian export shares. – [3] Dollar.

The low oil price stimulates economic activity world-wide, most of all in oil-importing countries. Substantial gains in private purchasing power boost internal demand of net importers, while net exporters lose external revenues. In most oil-exporting countries, oil export revenues largely accrue to the government. These countries are thus likely to move towards fiscal restriction with negative effects on aggregate demand, at least in the medium term, which in turn will dampen exports of oil-importing countries. Empirical estimates do not convey a clear picture for the impact of an oil price fall. For the world economy as a whole, the positive impact will be reduced to some extent by the adverse effect on activity in oil-exporting countries.

The low oil price improves the global economic environment.

Outside OPEC, the increase in oil production will decelerate only in a medium-term perspective, leaving overall oil supply conditions little changed over the forecast horizon, unless political events in major oil-producing countries lead to shortfalls in output. Oil futures quotations suggest a pick-up of prices from current low levels, while strengthening cyclical activity may provide additional upward pressure. Against this background, WIFO assumes the reference oil price at $ 70 per barrel on annual average 2015 and at $ 80 in 2016.

Monetary policy by the ECB is likely to remain expansionary over the entire forecast period.

The ECB's monetary policy is seeking to provide stimulus to economic activity. By lowering the key intervention rate to 0.05 percent in September 2014, the trend of disinflation ought to be arrested. While lower energy prices slowed down inflation towards the end of 2014, also core inflation that excludes energy items fell markedly in many euro area countries. Likewise, inflation expectations are still trending down in the euro area, fuelling concerns of deflation. Against this background, the ECB Council on 22 January 2015 decided on a comprehensive programme of securities purchases ("quantitative easing") to the amount of over € 1 billion. The programme foresees the purchase of government bonds by the ECB and the national Central Banks, coordinated by the ECB, up to a ceiling of 33 percent of a euro area country's outstanding government debt. The programme may be extended further and is not limited in time.

The impact of the ECB's expansionary impulses of the last few months on the real economy is likely to be small, as suggested by the transmission mechanism chosen by the ECB: the ECB opted for the purchase of government bonds on the secondary market in order to influence corporate investment decisions. However, interest rates on euro area government bonds are already extraordinarily low and banks have almost unlimited and costless access to central bank money. Thus, banks' credit rates and their decisions to grant credit to risky debtors have already for some time been independent of costs and restrictions to central bank refinancing.

A monetary policy decision with potentially far-reaching consequences for the Austrian economy was the move by the Swiss National Bank to abandon the minimum euro exchange rate for the Swiss Franc of CHF 1.20 per euro introduced more than three years ago. This move will likely weaken the financial situation of borrowers indebted in Swiss Francs. On the other hand, the waiver of the CHF/euro exchange rate peg should benefit Austrian exports to Switzerland.

A tightening of macro-prudential policy in accordance with the implementation road map of "Basle III" in 2015 is unlikely to change bank lending standards substantially.

Unlike monetary policy, macro-prudential management is embarking on a tightening stance. This is largely in line with the road map for the implementation of "Basle III". The latest measure taken in early 2015 by the Financial Market Stability Board (Finanzmarktstabilitätsgremium – FMSG), i.e., the introduction of a Minimum Liquidity Coverage Ratio, should not have led to a restraint in domestic bank lending as the liquidity glut generated by the ECB is thwarting the tighter liquidity standards. In 2016, the tools of macro-prudential supervision will be enlarged by the countercyclical capital buffer and an additional capital buffer for systemic financial institutions. Developments in the next months will show to what extent these innovations lead to a change in the macro-prudential environment. At the moment, neither their impact on bank lending nor on the real economy can be anticipated.

The assumptions concerning domestic fiscal policy have changed slightly from the WIFO projections of December 2014.

The present macroeconomic forecast takes on board the fiscal measures so far adopted or measures that have been sufficiently specified and the adoption of which are deemed likely. For this reason, the forecast includes neither the potential effects of a tax reform on the real economy in Austria, nor the impact of the investment initiative recently decided at EU level (the envisaged scope of the initiative has been announced, but no details about the allocation of financial resources over time and between EU member countries have yet been clarified).

A construction investment programme has now been added to the assumptions: according to an announcement of mid-February 2015, the Federal Real Estate Agency (Bundesimmobiliengesellschaft) will build 10,000 dwellings of a total investment volume of € 2 billion over the next six years. Due to the important lead time inherent in such large-scale projects, economic effects of this initiative will materialise only as from 2016.

Table 3: Key policy indicators

	2011	2012	2013	2014	2015	2016
	As a percentage of GDP					
Fiscal policy						
General government financial balance						
According to Maastricht definition	– 2.6	– 2.3	– 1.5	– 2.8	– 2.2	– 1.9
General government primary balance	0.1	0.4	1.1	– 0.3	0.3	0.6
	In percent					
Monetary policy						
3-month interest rate	1.4	0.6	0.2	0.2	0.1	0.1
Long-term interest rate[2]	3.3	2.4	2.0	1.5	0.5	0.5
	Percentage changes from previous year					
Effective exchange rate						
Nominal	+ 0.2	– 1.5	+ 1.7	+ 1.2	– 2.2	± 0.0
Real	+ 0.6	– 1.6	+ 2.0	+ 1.5	– 1.5	– 0.3

Source: WIFO. 2015 to 2016: forecast. – [1] 10-year central government bonds (benchmark).

Like the revision of last December, the present forecast assumes public consumption to stay on an upward trend, growing by 2.5 percent in nominal terms in 2015 and 2016, respectively. The public sector contribution to real GDP growth of 0.2 percentage points per year is in line with the one recorded in the last few years. The general government deficit is likely to narrow somewhat over the forecast horizon.

3. Outlook for the Austrian economy

Economic growth in Austria is expected to strengthen only gradually. For spring 2015 no firm recovery is yet in sight. On the other hand, there are no hints for a relapse into recession. Compared with the assumptions underlying the WIFO projections of September and December 2014, two significant macroeconomic shocks have since occurred: the fall in oil prices and the sustained depreciation of the euro. Each of these taken by itself should give firm support to business activity. The low oil price implies for net importers substantial purchasing power gains that will foster domestic demand. The benign exchange rate should give fresh momentum to export growth. Yet, the oil price level on a euro basis is not lower than before the price slump and the assumption for 2015 has hardly changed from the one included in the forecast of last December. The lower energy prices should therefore not be expected to provide major stimulus to domestic activity in 2015.

3.1 Leading indicators suggest sluggish activity in spring

The picture conveyed by current leading indicators is, like in December 2014, rather uniform and pointing to a gloomy short-term outlook. Indicators for February weakened markedly from the previous month. Some key figures are now still lower than in mid-December 2014. The latest WIFO Business Cycle Survey of February 2015 reflects firms' persistent scepticism: judgements of the current situation and of the short-term outlook were more pessimistic than one month earlier. The index for the assessment of the current situation (for the whole economy, seasonally adjusted) dropped sharply from January to February, matching the trough recorded in April 2013. The decline was largely driven by developments in manufacturing, although the trend was similarly negative in services and the construction sector. Business expectations also worsened most in manufacturing.

The growing scepticism in the manufacturing sector is the consequence of slackening output growth and lower order levels. The decline in business expectations mainly derives from a more pessimistic assessment of output developments and business conditions for the next few months. Also the expectations for employment remain adverse. Judgements on the current situation turned particularly negative among producers of intermediate goods and less so among producers of investment and consumer goods. The index of business expectations, for its part, fell most in the investment goods branch and to a lesser extent in the intermediate and the consumption goods industries.

As revealed by the international comparison, the business climate deteriorated in Austria from January to February more than in any other EU member countries. On average for the euro area as well as for the EU 28, it even improved somewhat.

Likewise, the Purchasing Managers Index compiled by Bank Austria shows a lasting, albeit decelerating downward trend for the domestic manufacturing industry. Although the index edged up to 48.7 points in February, a reading below 50 signals further output losses from the previous month. Meanwhile, the index has hovered below the growth threshold for the last half year. According to the latest survey, employment has been reduced and commodity purchases have been cut despite the strong fall in energy prices. Firms are also cautious in managing their inventories. It is obvious that the Austrian industrial companies remain highly sceptical with regard to further business developments.

After a small uptick in January, the WIFO Leading Indicator is again heading down in February. Nevertheless, the downward trend observed last year has flattened markedly and may come to a halt, possibly turning around in spring.

Similarly pessimistic is the general mood of private households. Consumer confidence remains stuck at a low level and, contrary to the overall sentiment in the euro area, has not improved in the last months. The main factor for the low confidence of domestic consumers, apart from pessimistic expectations as regards the own financial situation as well as the overall economic outlook, is the deterioration of the labour market. The possibility of becoming unemployed in the course of the next twelve months is rated similarly high as in late 2009. Since a potential job loss implies a reduction in personal income, consumers are at present reluctant to raise their spending.

The message conveyed by the indicators suggests that the current cyclical downturn will gradually ebb and that the lower turning point may be reached by the middle of 2015.

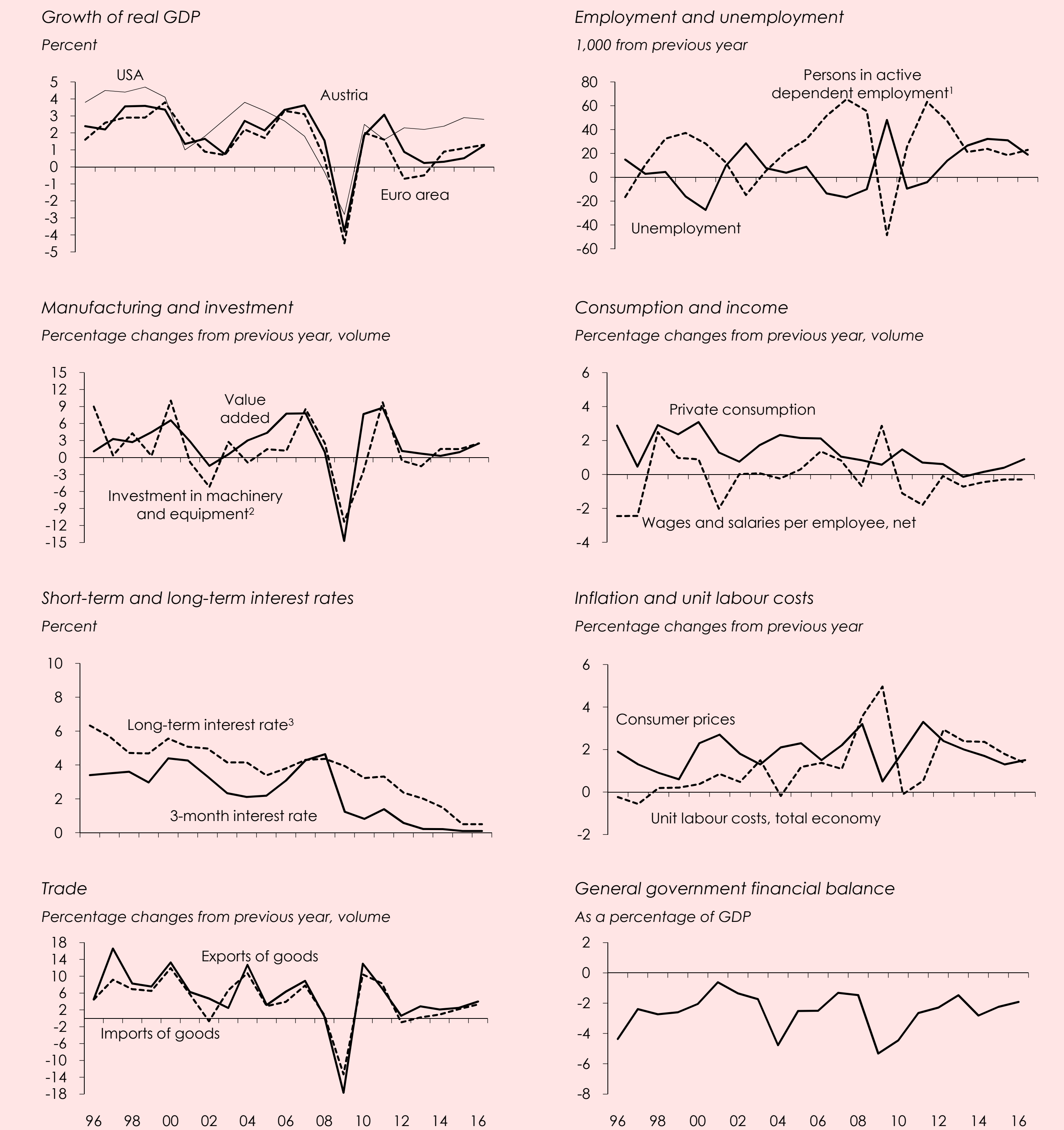
After the cyclical "soft patch", the Austrian economy is set to regain momentum only in 2016.

The revised external environment with a rebound of export markets, the benign euro exchange rate and lower oil prices – in 2016 also on a euro basis – warrants an upward revision of the GDP growth projection of December 2014. On the other hand, growth in late 2014 confirmed the downbeat expectations, and latest leading indicators do not point to an imminent revival. In the short run, the conditions for a stepwise pick-up of demand and output in Austria are hardly in place. The sluggish pace of GDP since the beginning of 2014 is likely to extend into the first quarter 2015. Against this background, the cyclical pattern for 2015 is that of a sticky recovery (Figure 1). Higher quarterly growth rates may therefore be expected only by the end of 2015 and in 2016.

The cyclical profile illustrated in Figure 2 would yield annual rates of GDP growth of 0.5 percent for 2015 and 1.3 percent for 2016. Assuming potential growth at around 1 percent p.a., the Austrian economy would in 2015 continue to perform below capacity[1]. A normal degree of capacity utilisation will not be reached within the forecast period. Only in 2016 GDP growth will marginally exceed potential output growth, thereby reducing the scope of under-utilisation. The negative output gap will not be closed by the end of the forecast horizon.

[1] This estimate is based on a re-calculation of potential output (Baumgartner, J., Kaniovski, S., Pitlik, H., "Wirtschaftswachstum weiterhin verhalten, Arbeitslosigkeit bleibt hoch. Mittelfristige Prognose der österreichischen Wirtschaft bis 2019", WIFO-Monatsberichte, 2015, 88(1), pp. 51-66, http://monatsberichte.wifo.ac.at/ 50923).

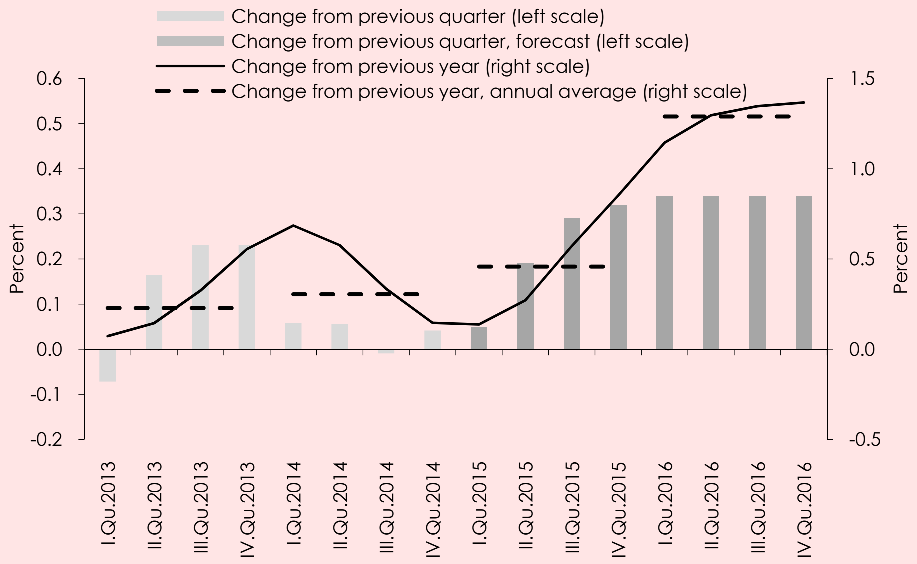
Figure 1: Indicators of economic performance



Source: WIFO. 2014 to 2016: forecast. – [1] Excluding parental leave, military service, and unemployed persons in training. – [2] 10-year central government bonds (benchmark).

As illustrated by the high carry-over from 2013 and the slow pace during 2014, the larger part of the 2014 annual GDP growth rate was a pay-back from the previous year. In 2015, both effects will move in the opposite direction, i.e., a carry-over from 2014 of almost zero, coupled with strong growth of 0.9 percent within 2015 (Table 4). Should the latter not prove realistic by this spring, the projected annual GDP growth rate of 0.5 percent would appear highly optimistic. In 2016, a high growth rate of 1.4 percent during the year, coupled with a rather strong statistical overhang of 0.4 percent from 2015, add up to annual GDP growth of 1.3 percent.

Figure 2: Cyclical profile for Austria



Source: WIFO.

Table 4: Technical assumptions for the GDP growth projection

		2013	2014	2015	2016
Carry-over[1]	percentage points	+ 0.0	+ 0.3	+ 0.0	+ 0.4
Growth during the year[2]	percentage changes from previous year	+ 0.6	+ 0.1	+ 0.9	+ 1.4
Annual average	percentage changes from previous year	+ 0.2	+ 0.3	+ 0.5	+ 1.3

Source: WIFO. 2015 to 2016: forecast. – [1] Annual rate of change, if GDP for the current year remains constant at the level of the fourth quarter of the previous year, trend-cycle component. – [2] Year-on-year rate of change in the fourth quarter, trend-cycle component.

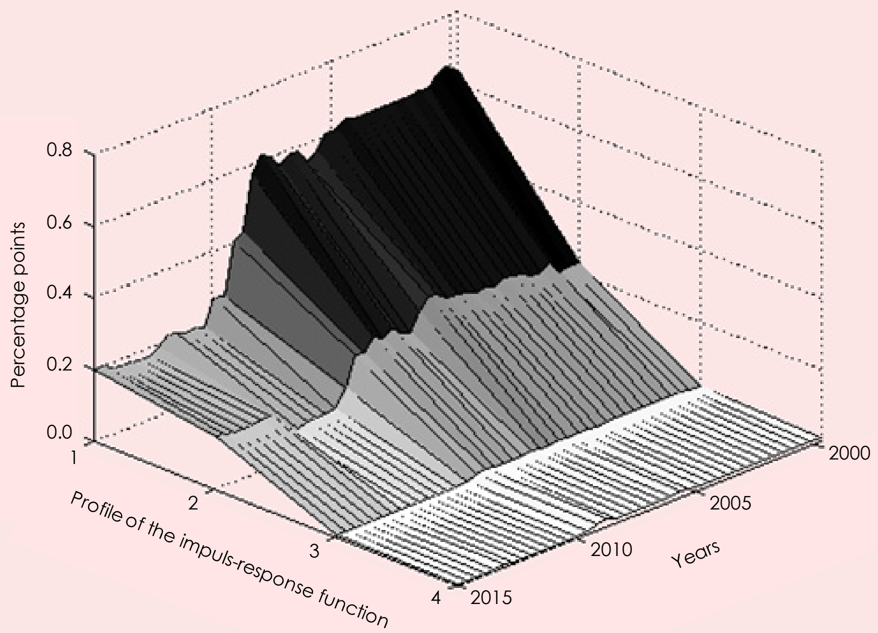
The projection for annual GDP growth for 2015 has thus remained unchanged from the WIFO forecast of last December, but the quarterly profile has been adjusted according to the messages received from the leading indicators. This concerns mainly the first quarter 2015, which has been slightly revised down. Growth expectations for 2016 have been lifted up somewhat, for two reasons: first, lower oil prices (on a euro basis), the weak euro exchange rate and the more benign external environment should provide stronger positive incentives than had been assumed in December; second, construction activity should expand more strongly than anticipated, benefiting from the government investment programme recently adopted.

Significantly more favourable than at the time of the December forecast is at present the external environment, particularly in the euro area, warranting the expectation of stronger growth incentives over the forecast period. Nevertheless, exports and GDP growth for 2015 have not been adjusted in this respect, mainly because of the connection between the performance of the Austrian economy and the rest of the euro area becoming noticeably looser (Figure 3). As demonstrated by the structural impulse-response functions[2], a growth impulse in the euro are of 1 percentage point during the period from 2000 to 2008 was associated with a simultaneous acceleration of GDP growth in Austria by around 0.7 percentage points. This effect has become much weaker since: nowadays, such an impulse from the euro area of the same magnitude may boost Austria's GDP growth by only 0.2 percentage points.

[2] The structural impulse-response functions are based upon the a-posteriori density of a Bayesian Vector Autoregressive model. Structuring has been carried out using a Cholesky decomposition. Modelling of the variation of parameters over time is based on rolling regressions.

The weaker correlation also explains the maintenance of positive, albeit modest GDP growth in Austria in 2012-13 despite the recession that struck the euro area.

Figure 3: Interdependence between the Austrian economy and the euro area



Source: WIFO. Structural impulse-response functions based upon the *a-posteriori* density of a Bayesian Vector Autoregressive model.

The GDP forecast is contingent upon an acceleration of export growth.

A key precondition for the GDP path illustrated is an acceleration of export growth. After +0.8 percentage points in 2014, the growth contribution of exports should rise markedly in the following years, due to the pick-up in world trade and global activity. Especially deliveries to crucial export markets like Switzerland and the US should expand noticeably.

At the same time, however, imports will increase. Hence, the net foreign contribution to GDP growth may be slightly negative in 2015 and close to zero in 2016.

3.2 Corporate investment still providing only small contribution to GDP growth

Despite persistent low interest rates, investment will fare below-average.

Due to the sluggish industrial activity prevailing, corporate investment should remain subdued, only picking up in the course of 2016. Barring any further disturbance of the investment climate, better sales prospects and higher capacity utilisation should encourage firms to invest in machinery, business equipment and commercial buildings. Financing conditions remain highly favourable and will be conducive to the normalisation of investment behaviour. Nevertheless, low interest rates will hardly lead to a substantial enlargement of productive capacities in Austria; a restraining factor is the heightened risk awareness of companies, brought about by the repeatedly disappointed expectations in recent years. In such circumstances, even investment-supportive conditions like ample corporate financial assets will not exert their full effect.

3.3 Purchasing power gains thanks to lower inflation

The high and still rising tax burden is eating into private purchasing power despite decelerating inflation.

The unfavourable labour market situation and declining average work hours put a brake on the increase in per-capita wages (2015 +1.5 percent, 2016 +1.7 percent in nominal gross terms). Labour market conditions and modest wage growth thus undermine private purchasing power. Against this background, private consumption is expected to expand only moderately over the forecast period. Although easing inflation will benefit purchasing power in 2015, the growth contribution of private consumption will nevertheless be small given the gloomy consumer sentiment, possibly heading up in 2016.

Table 5: Earnings and international competitiveness

	2011	2012	2013	2014	2015	2016
	Percentage changes from previous year					
Gross earnings per employee[1]	+ 1.8	+ 2.7	+ 1.7	+ 1.7	+ 1.5	+ 1.7
Gross real earnings per employee[2]	– 1.4	+ 0.3	– 0.3	+ 0.0	+ 0.2	+ 0.2
Net real earnings per employee[2]	– 1.8	– 0.1	– 0.7	– 0.5	– 0.3	– 0.3
Unit labour costs						
Total economy	+ 0.5	+ 2.9	+ 2.4	+ 2.4	+ 1.8	+ 1.4
Manufacturing	– 3.2	+ 3.7	+ 1.8	+ 1.6	+ 0.7	– 0.7
Effective exchange rate, manufactures						
Nominal	+ 0.1	– 1.7	+ 1.8	+ 1.2	– 2.2	± 0.0
Real	+ 0.5	– 1.7	+ 2.1	+ 1.5	– 1.6	– 0.3

Source: WIFO. 2015 to 2016: forecast. – [1] Employees according to National Accounts definition. – [2] Deflated by CPI.

On the basis of the assumptions for oil prices and exchange rates, the sharp decline in oil product prices (mainly motor fuels and domestic heating fuel) will turn to a moderate upward path. Hence, the outlook for CPI inflation in Austria are annual rates of 1.3 percent and 1.5 percent in 2015 and 2016, respectively, a downward revision from the December 2014 forecast by 0.2 percentage points for 2015 and 0.1 percentage point for 2016. In spite of the overall moderation, domestic headline inflation remains distinctly higher than the euro area average.

Table 6: Private consumption, income and prices

	2011	2012	2013	2014	2015	2016
	Percentage changes from previous year, volume					
Private consumption expenditure	+ 0.7	+ 0.6	– 0.1	+ 0.2	+ 0.4	+ 0.9
Durables	+ 4.6	– 0.1	– 3.2	+ 0.4	+ 0.5	+ 2.0
Non-durables and services	+ 0.3	+ 0.7	+ 0.2	+ 0.1	+ 0.4	+ 0.8
Household disposable income	– 1.1	+ 1.9	– 2.1	+ 0.3	+ 0.5	+ 1.1
	As a percentage of disposable income					
Household saving ratio						
Including adjustment for the change in net equity of households in pension fund reserves	7.8	9.0	7.3	7.4	7.4	7.6
Excluding adjustment for the change in net equity of households in pension fund reserves	7.1	8.3	6.5	6.6	6.6	6.8
	Percentage changes from previous year					
Direct lending to domestic non-banks[1]	+ 2.7	+ 0.0	– 1.2	+ 0.3	+ 1.0	+ 1.2
	Percentage changes from previous year					
Inflation rate						
National	3.3	2.4	2.0	1.7	1.3	1.5
Harmonised	3.6	2.6	2.1	1.5	1.2	1.5
Core inflation[2]	2.8	2.3	2.3	1.9	1.8	1.5

Source: WIFO. 2015 to 2016: forecast. – [1] End of period. – [4] Excluding unprocessed food (meat, fish, fruits, vegetables) and energy items.

3.4 Job growth along with further rising unemployment

GDP growth is largely driven by productivity advances, while the total number of hours worked by dependent employees is barely rising.

Leading indicators of labour market developments remain ambivalent, despite sluggish GDP growth during 2014 and the dim short-term outlook.

In parallel with rising employment, unemployment will nevertheless increase further, due to the buoyant expansion of labour supply. After a rise in the unemployment rate (national definition) by 0.8 percentage points to 8.4 percent of the dependent labour force in 2014, WIFO expects rates of 9.1 percent and 9.4 percent for 2015 and 2016, respectively. The upward trend is, however, biased upwards by a change in labour market policy leading to a decline in the number of persons enrolled in job training (who are not registered as openly unemployed). On the other hand, the persistently rising trend observed since 2011 points to ossification tendencies in the labour market.

Table 7: Labour market

		2011	2012	2013	2014	2015	2016
		Changes from previous year, in 1,000					
Demand for labour							
Persons in active employment[1]		+ 69.9	+ 50.1	+ 29.3	+ 29.7	+ 23.5	+ 28.0
Employees[2]		+ 63.3	+ 47.2	+ 21.2	+ 23.8	+ 18.5	+ 23.0
Percentage changes from previous year		+ 1.9	+ 1.4	+ 0.6	+ 0.7	+ 0.5	+ 0.7
Nationals		+ 25.7	+ 9.0	– 8.5	– 8.1	– 3.5	– 3.0
Foreign workers		+ 37.7	+ 38.1	+ 29.7	+ 32.0	+ 22.0	+ 26.0
Self-employed[3]		+ 6.6	+ 2.9	+ 8.1	+ 5.9	+ 5.0	+ 5.0
Labour supply							
Population of working age	15 to 64 years	+ 31.3	+ 18.0	+ 23.5	+ 28.4	+ 25.5	+ 23.3
	15 to 59 years	+ 11.7	+ 22.3	+ 27.2	+ 28.2	+ 18.7	+ 8.5
Labour force[4]		+ 65.8	+ 64.0	+ 55.9	+ 61.9	+ 54.5	+ 47.0
Surplus of labour							
Registered unemployed[5]		– 4.1	+ 13.9	+ 26.6	+ 32.2	+ 31.0	+ 19.0
In 1,000		246.7	260.6	287.2	319.4	350.4	369.4
Unemployed persons in training[5]	in 1,000	63.2	66.6	73.5	75.3	61.3	58.3
		In percent					
Unemployment rate							
Eurostat definition[6]		4.2	4.3	4.9	5.0	5.3	5.3
As a percentage of total labour force[5]		6.0	6.2	6.8	7.4	8.1	8.4
National definition[5,7]		6.7	7.0	7.6	8.4	9.1	9.4
Employment rate							
Persons in active employment[1,8]		66.6	67.2	67.5	67.6	67.8	68.0
Total employment[6,8]		72.1	72.5	72.3	72.6	72.7	72.8

Source: WIFO. 2015 to 2016: 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).

Table 8: Productivity

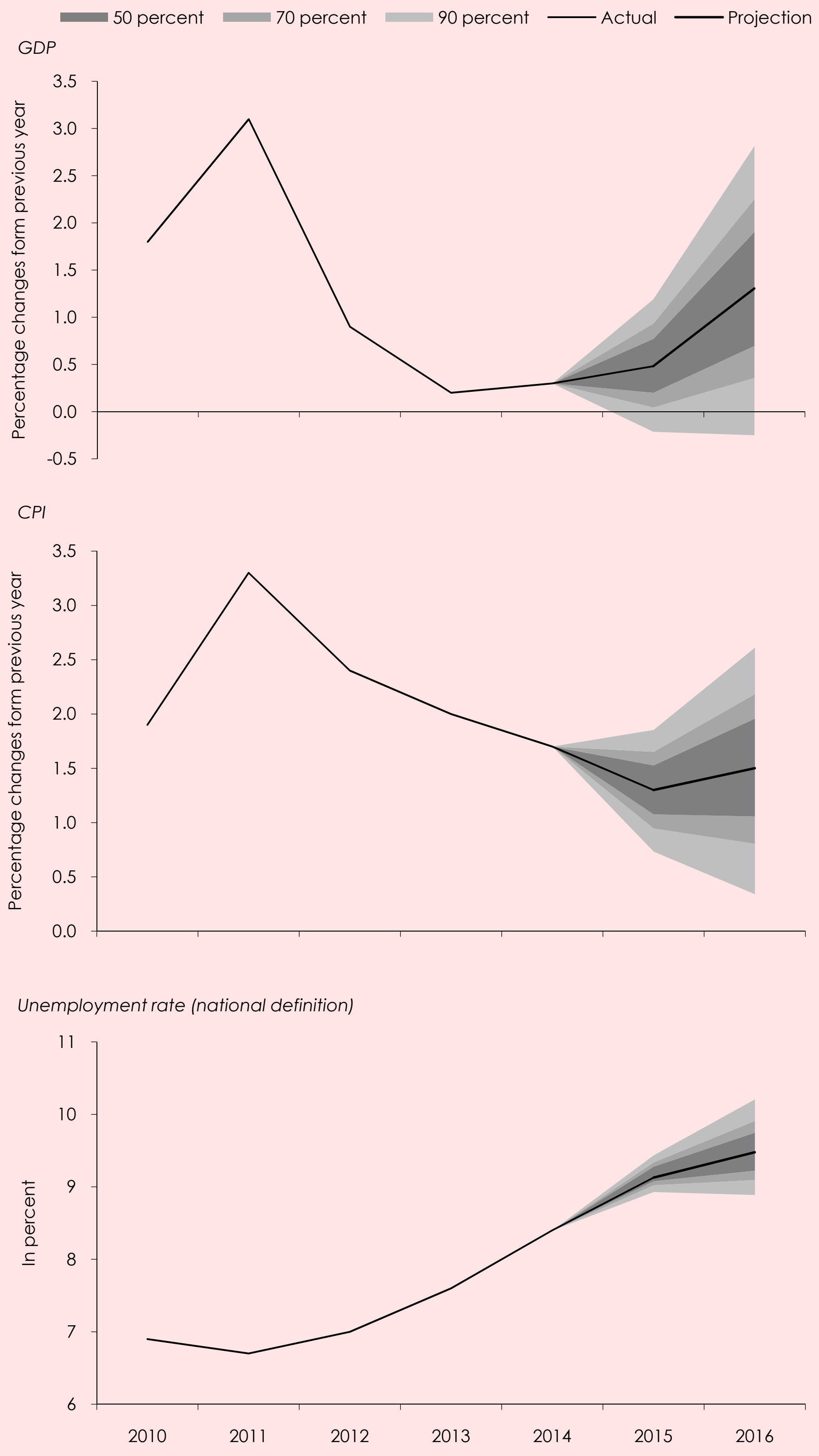
	2011	2012	2013	2014	2015	2016
	Percentage changes from previous year					
Total economy						
Real GDP	+ 3.1	+ 0.9	+ 0.2	+ 0.3	+ 0.5	+ 1.3
Hours worked[1]	+ 2.0	– 0.1	– 0.5	+ 0.9	– 0.1	+ 0.1
Productivity per hour	+ 1.1	+ 1.0	+ 0.7	– 0.6	+ 0.6	+ 1.2
Employment[2]	+ 1.7	+ 1.1	+ 0.7	+ 0.9	+ 0.8	+ 0.8
Manufacturing						
Production[3]	+ 8.8	+ 1.2	+ 0.7	+ 0.3	+ 1.0	+ 2.5
Hours worked[1]	+ 1.6	+ 1.2	– 0.4	– 0.6	– 0.4	– 0.1
Productivity per hour	+ 7.0	– 0.1	+ 1.1	+ 0.9	+ 1.4	+ 2.6
Employees[1]	+ 1.9	+ 1.6	– 0.1	+ 0.1	– 0.1	± 0.0

Source: WIFO. 2015 to 2016: forecast. – [1] According to National Accounts definition. – [2] Dependent and self-employed according to National Accounts definition. – [3] Value added, volume.

Employment growth is characterised by an increasing number of jobs, while at the same time the average number of work hours per employee recedes. Hence, the total number of work hours will edge up only marginally. In a medium-term perspective, employment growth will probably slow down, while labour productivity growth is set to pick up. Due to the demographic decline in the population of Austrian nationality, the net increase in employment is sustained by foreign labour force.

Job creation is primarily driven by the service sector. In manufacturing, both the number of jobs and per-capita work hours are expected to decrease further. Also the overall number of work hours in the economy is broadly flat, such that GDP growth is largely generated by productivity advances.

Figure 4: Margins of uncertainty for the forecast of GDP, CPI and unemployment rate



Source: WIFO. Based on the posterior distribution of a Bayesian Vector Autoregressive model.

4. The risk environment

Experience shows economic forecasts to be surrounded by a considerable margin of uncertainty. Next to the establishment of the most likely path (baseline scenario), the assessment of qualitative and quantitative risks constitutes a key element of a forecast. This relates not only to the external assumptions referred to above, but also other factors of uncertainty to which point estimates are subject. Hence we have calculated margins of uncertainty for the key results of our forecast (Figure 4). The risk profiles include alternatives to the assumptions presented in the table "assumptions on the external environment".

The major risks to global economic growth derive from

- geo-political risks and their negative repercussions on commodity markets and the real economy,
- turbulence on financial markets following an abrupt price correction on global stock markets, and
- disappointment of growth expectations in major countries or regions.

Stock markets have recently been booming, with not only risk premia being low, but also market volatility. There is, however, a potential risk inherent in the prevailing situation, since low interest rates drive many investors into high-risk assets.

Domestic factors of uncertainty mainly concern the policy environment, with upside and downside risks broadly evening out.

The envisaged income tax cuts, not yet taken on board by the forecast, would constitute an upward risk to growth that may be compounded over the medium term by structural reforms; on the other hand, the stimulus created by the income tax cuts may be neutralised by the measures of counter-financing the inherent revenue losses.

Apart from the tax reform, the EU investment initiative adopted by the European Commission represents an upward risk for the growth projection. At present it is, however, not possible to assess its potential scope, due to the lack of information concerning its implementation.