

Marcus Scheiblecker

International Economic Activity Abating from Strong Growth in 2018

Economic Outlook for 2018 and 2019

International Economic Activity Abating from Strong Growth in 2018. Economic Outlook for 2018 and 2019

Leading indicators still point to favourable cyclical conditions in Austria until the end of 2018. GDP growth for the year as a whole is set to reach 3 percent. Currency crises in some emerging market countries, lack of clarity about the further course of US trade policy, and uncertainty surrounding the terms of Brexit increasingly strain international trade and with it business activity in highly export-oriented economies. These factors will dampen GDP growth also in Austria, which is expected to recede to 2 percent in 2019.

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

All staff members of the Austrian Institute of Economic Research contribute to the Economic Outlook. For definitions used see "Methodological Notes and Short Glossary", <https://www.wifo.ac.at/wwwdocs/form/WIFO-BusinessCycleInformation-Glossary.pdf> • Cut-off date: 3 October 2018.

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ISSN 1605-4709 • © Austrian Institute of Economic Research 2018

Impressum: Herausgeber: Christoph Badelt • Chefredakteur: Michael Böheim (michael.boeheim@wifo.ac.at) • Redaktionsteam: Tamara Fellingner, 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

Demand and output growth has been further accelerating in Austria; after +2.0 percent in 2016 and +2.6 percent last year, real GDP is expected to gain 3.0 percent in 2018. In an international perspective, domestic business activity has so far proved remarkably robust, while in major euro area countries it has been clouded since early this year by slackening foreign trade. Although the growth cycle should have passed its peak also in Austria, the slowdown has so far been contained. Industrial production and exports still expanded markedly in the first half of the year.

Currency crises in several emerging market economies, the trade policy strategy in the USA and the so far inconclusive search for a viable solution for the UK withdrawal from the EU in 2019 currently overshadow world trade. Austria is therefore also likely to face slower export growth in 2019, which may weaken firms' readiness to invest. Private consumption should continue to lend support to aggregate demand, without however fully compensating the shortfall of demand from abroad. GDP growth in Austria is expected to moderate to an annual rate of 2 percent.

The rate of inflation remains at a stable 2.1 percent in 2018. The moderate pace, given the strong cyclical drive, is only slightly in excess of the ECB's target for the entire euro area (below, but close to 2 percent). In the current year it is mainly energy cost that is pushing up the consumer price level. In 2019, inflation may remain unchanged at an annual 2.1 percent.

The labour market continues to benefit from lively output growth. Overall employment is expected to increase by 88,000 persons (+2.5 percent) in 2018, the number of unemployed registered with the Public Employment Service Austria (AMS) keeps falling (-28,000 on annual average 2018). Monthly figures suggest the downward trend

coming to a halt since summer, the main reason is a decline in training activities. The overall positive trend is set to persist until the end of the year. In 2019, the pace of job creation is expected to decelerate and progress towards lower unemployment will be more limited than in 2018. The unemployment rate is projected to ease to an average 7.3 percent.

Table 1: Main results

	2014	2015	2016	2017	2018	2019	
	Percentage changes from previous year						
Gross domestic product, volume	+0.7	+1.1	+2.0	+2.6	+3.0	+2.0	
Manufacturing	+2.2	+1.3	+3.5	+4.8	+6.2	+3.2	
Wholesale and retail trade	+2.2	+1.9	+1.2	+1.1	+1.8	+1.6	
Private consumption expenditure ¹ , volume	+0.3	+0.4	+1.4	+1.4	+1.8	+1.7	
Consumer durables	-0.3	+1.9	+3.0	+0.5	+1.0	+0.5	
Gross fixed capital formation, volume	-0.4	+2.3	+4.3	+3.9	+3.4	+2.7	
Machinery and equipment ²	-1.4	+3.9	+10.6	+4.6	+4.7	+4.0	
Construction	+0.3	+0.1	+0.4	+3.5	+2.3	+1.5	
Exports, volume	+2.9	+3.5	+2.7	+4.7	+4.9	+3.7	
Exports of goods, fob	+2.9	+3.5	+2.1	+4.9	+5.6	+4.5	
Imports, volume	+3.0	+3.6	+3.4	+5.1	+4.0	+3.5	
Imports of goods, fob	+2.1	+4.1	+3.2	+4.2	+4.4	+4.0	
Gross domestic product, value	+2.9	+3.3	+3.5	+3.8	+4.7	+4.1	
	billion €	333.15	344.26	356.24	369.90	387.36	403.21
Current account balance as a percentage of GDP	2.5	1.7	2.5	2.0	1.9	2.0	
Consumer prices	+1.7	+0.9	+0.9	+2.1	+2.1	+2.1	
Three-month interest rate	percent	0.2	-0.0	-0.3	-0.3	-0.3	-0.2
Long-term interest rate ³	percent	1.5	0.7	0.4	0.6	0.7	1.0
General government financial balance, Maastricht definition as a percentage of GDP		-2.7	-1.0	-1.6	-0.8	-0.1	0.2
Persons in active dependent employment ⁴		+0.7	+1.0	+1.6	+2.0	+2.5	+1.5
Unemployment rate							
Eurostat definition ⁵		5.6	5.7	6.0	5.5	4.8	4.5
National definition ⁶		8.4	9.1	9.1	8.5	7.7	7.3

Source: WIFO. 2018 and 2019: forecast. – ¹ Including non-profit institutions serving households. – ² Including weapons systems. – ³ 10-year central government bonds (benchmark). – ⁴ Excluding persons in valid employment contract receiving child care benefit or being in military service. – ⁵ As a percentage of total labour force, Labour Force Survey. – ⁶ As a percentage of dependent labour force, unemployed persons according to Public Employment Service Austria.

1. Cyclical upswing had set in already in 2016

After the revision of the National Accounts for 2016 and the first release for 2017 by Statistics Austria, the cyclical upswing reveals a profile that is different from the one underlying the WIFO forecast of June 2018: accordingly, GDP growth for 2016 has turned out significantly higher (+2.0 percent) than originally reported by the official statistics (+1.5 percent). Conversely, Statistics Austria's first estimate for the growth rate for 2017 of +2.6 percent falls short of the preliminary WIFO calculation of May 2018 of +3.0 percent, based on the quarterly National Accounts. From today's perspective, the upswing was thus less dynamic in 2017 than suggested by the highly positive results of the business surveys and the employment figures.

The revision was particularly marked for the cyclically-sensitive manufacturing sector (ÖNACE C) which contributes about one-fifth to aggregate output: whereas earlier calculations had shown a substantial acceleration from +0.6 percent in 2015 and +1.3 percent in 2016 to +6.8 percent in 2017 (WIFO preliminary National Accounts for 2017), the new figures yield a much flatter profile with annual rates of +1.3 percent, +3.5 percent and +4.6 percent, respectively. Likewise, the revision of manufacturing labour input figures reveals a different shape of productivity advances: according to the previous calculations, real value added per man-hour (of dependent employees) edged up by 0.8 percent in 2015 and 0.6 percent in 2016, before jumping by 4.0 percent in 2017, while the new results show more moderate progress (+1.5 percent, +3.1 percent and +3.2 percent, respectively).

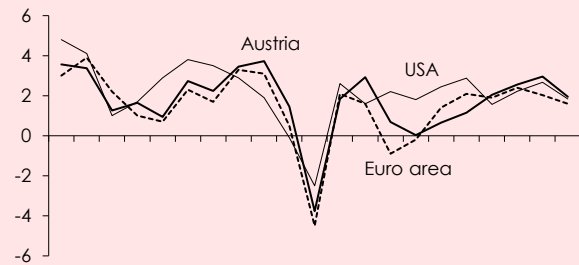
On the expenditure side of GDP, the revision of private consumption has been minor, broadly confirming the volume pick-up from +0.4 percent in 2015 to +1.4 percent in 2016 (first release from +0.5 percent to +1.5 percent), triggered by the tax reform of

GDP growth in Austria has gradually accelerated over the past years, reaching a peak at the turn of 2017-18. The above-average momentum extended into the first half of 2018.

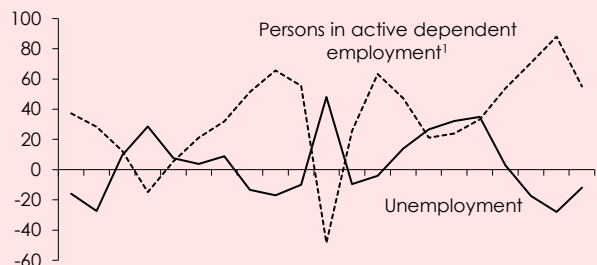
2016. The fading of the tax cut effect in 2017 was offset by higher wage gains in the light of stronger business activity, as household consumption maintained a pace of +1.4 percent.

Figure 1: Indicators of economic performance

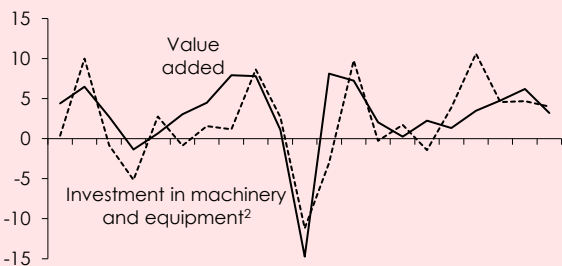
Growth of real GDP
Percent



Employment and unemployment
Change from previous year in 1,000



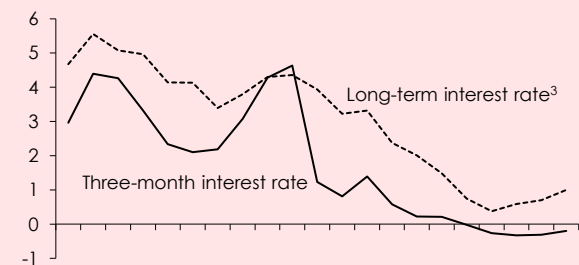
Manufacturing and investment
Percentage changes from previous year, volume



Consumption and income
Percentage changes from previous year, volume



Short-term and long-term interest rates
Percent



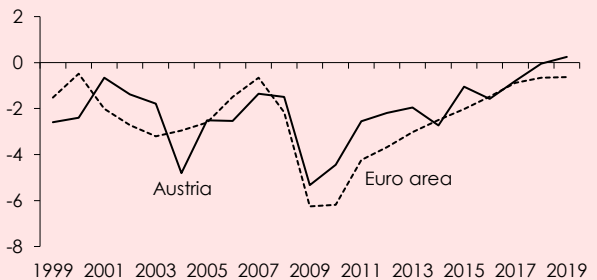
Inflation and unit labour costs
Percentage changes from previous year



Trade (according to National Accounts)
Percentage changes from previous year, volume



General government financial balance
As a percentage of GDP



Source: WIFO. 2018 and 2019: forecast. – ¹ Excluding persons in valid employment contract receiving child care benefit or being in military service, and unemployed persons in training; break in 2007-08 due to changes in the employment statistics. – ² Including weapons systems. – ³ 10-year central government bonds (benchmark).

Investment in machinery and equipment however, expanded much more strongly, by 3.9 percent in 2015 and 10.6 percent in 2016 than earlier reported by Statistics Austria (+1.5 percent and +8.6 percent, respectively). For 2017, WIFO had estimated +8.2 percent last May, while the first official calculation shows a rate of only +4.6 percent. Construction investment, on the other hand, grew less in 2015 and 2016 than earlier released by Statistics Austria, but more strongly in 2017 than WIFO had expected.

GDP growth in 2017

The buoyancy of several cyclical indicators points to a marked acceleration of economic growth in 2017: the improvement of results in the regular WIFO-Konjunkturtest (business cycle survey) started in the second half of 2016, strengthened over the whole of 2017 and peaked in early 2018. In the key manufacturing sector (ÖNACE C), growth in terms of production accelerated from 2.7 percent in 2016 to 4.6 percent in 2017. Production sold rose by more than 5 percent (after less than +1 percent in 2016). In addition, the creation of new jobs, also increasingly those full-time, gathered pace.

Against this background, the annual GDP growth rate of 2.6 percent reported by Statistics Austria appears relatively low. Notably manufacturing industry value added (production of goods) appears to have turned out less dynamic than sales and output, thereby showing a weaker performance than in earlier episodes of cyclical upswing. On the evidence from the latter, WIFO had expected a better outcome for 2017. As new information becomes available, Statistics Austria will still proceed to several revisions of the GDP growth figure for 2017, with the final result not to be released before 2021. In the past, such revisions from the first to the second release have at times been significant, up to 0.6 percentage points (Figure 2), with upward revisions being more frequent than downward ones.

Figure 2: Revisions to growth rates of real GDP

Difference between first release by Statistics Austria and first revision in subsequent year



Source: Statistics Austria, WIFO calculations. Missing years: omitted due to statistical reclassifications and adjustments to the System of National Accounts.

2. Business activity in USA stimulated by expansionary fiscal policy

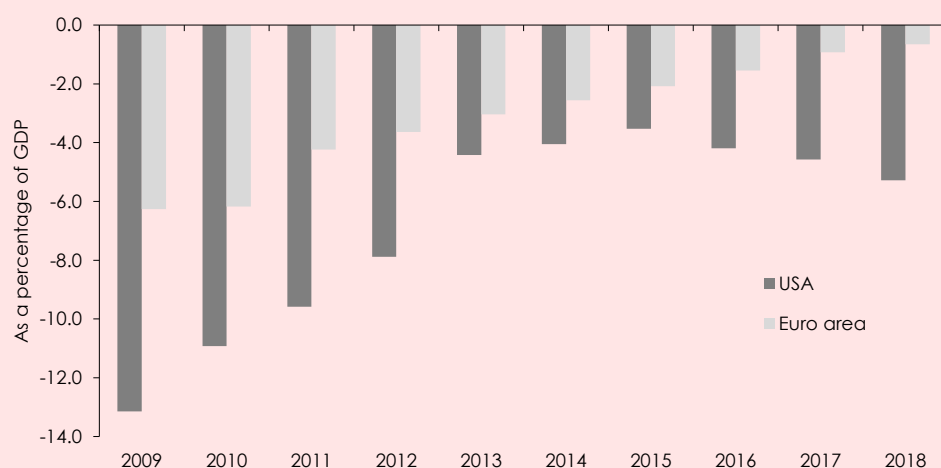
Demand and output in the USA rose by 1 percent in the second quarter from the previous period, corresponding to an annualised growth rate of 4.2 percent. The second-longest cyclical upturn of the last 50 years thereby continues with fresh momentum.

The unemployment rate has for some time fallen back to its low of the late 2000s. Although latest data indicate some acceleration in real wage gains, it is still rather marginal.

The expansionary fiscal stance is giving additional impetus to private demand. Since 2016, the general government deficit has steadily widened despite the benign cyclical conditions, moving up by a further 1 percentage point of GDP year-on-year in 2018. In the euro area, on the contrary, the comparatively less dynamic upswing has been accompanied by gradually narrowing deficits (Figure 3).

Despite strong cyclical activity, the US general government deficit has been widening over the last years.

Figure 3: General government net lending or net borrowing in the USA and the euro area



Source: Eurostat, IMF, WDS – WIFO Data System, Macrobond. 2018: forecast.

As different from fiscal policy, the US monetary policy follows a more restrictive line. After the Federal Reserve's latest raise of the key interest rate in late September by 25 basis points to 2.0 to 2.25 percent, further moves should be expected.

The boom of the US economy is set to continue throughout 2018. The ISM Purchasing Managers' Index rose substantially in August to a long-term high. Likewise, the Consumer Confidence Index of the Conference Board reached its highest level in 18 years in September. WIFO therefore expects US GDP to increase by an annual 2.7 percent, abating to +1.8 percent in 2019.

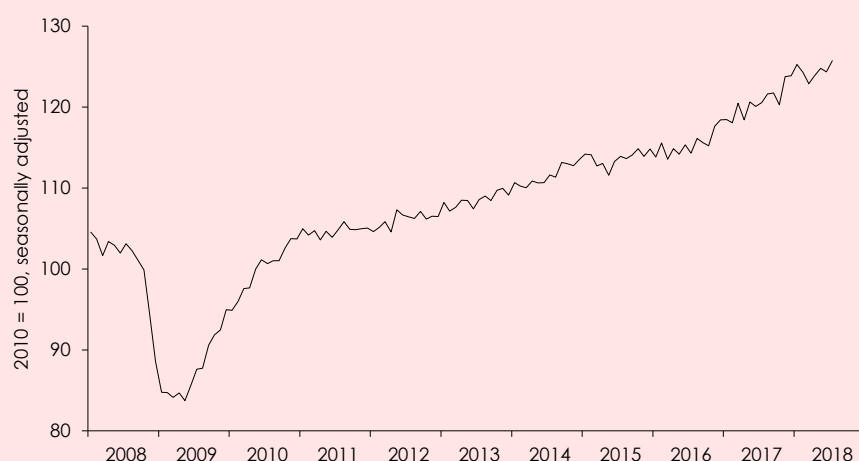
3. Uncertainty surrounding trade policy, Brexit and currency turbulence in emerging markets weigh on international trade

After the protracted sluggishness in the last years, world trade has picked up markedly since the end of 2016. However, the rise came to halt in early 2018, with the world trade index of the CPB broadly stagnating since (Figure 4). The coincidence of several negative factors is responsible for this levelling-off: the US trade policy gave rise to tariff conflicts with other major trading partners, thereby adding to uncertainty in merchandise trade. The external trade climate is further undermined by the persisting lack of clarity about the status of the UK after leaving the EU at the end of March 2019.

Currency turbulences in a number of emerging market countries tend to reinforce these adverse effects on global trade. Since the beginning of the year, the Argentine peso has lost half, the Turkish lira over one-third of its external value against the dollar and the euro. Also the Brazilian Real and the South African rand have massively depreciated.

Given these external conditions and in the light of latest developments, WIFO maintains its earlier assessment of an imminent slowdown of global economic activity.

Figure 4: Performance of global merchandise trade volumes since 2008



Source: CPB World Trade Monitor, Macrobond.

Table 2: International economy

	Percentage shares 2017		2014	2015	2016	2017	2018	2019
	Austria's exports of goods	World GDP ¹	GDP volume, percentage changes from previous year					
EU	69.8	16.5	+ 1.8	+ 2.3	+ 2.0	+ 2.4	+ 2.2	+ 1.7
UK	2.8	2.3	+ 2.9	+ 2.3	+ 1.8	+ 1.7	+ 1.3	+ 1.3
Euro area	52.2	11.6	+ 1.4	+ 2.1	+ 1.9	+ 2.4	+ 2.0	+ 1.6
Germany	30.2	3.3	+ 2.2	+ 1.7	+ 2.2	+ 2.2	+ 1.9	+ 1.6
Italy	6.4	1.8	+ 0.1	+ 1.0	+ 0.9	+ 1.5	+ 1.2	+ 1.2
France	4.9	2.2	+ 1.0	+ 1.1	+ 1.2	+ 2.2	+ 1.5	+ 1.3
CEE ²	14.3	1.6	+ 3.2	+ 4.0	+ 2.8	+ 4.4	+ 4.2	+ 2.9
Czech Republic	3.7	0.3	+ 2.7	+ 5.3	+ 2.5	+ 4.3	+ 3.0	+ 2.5
Hungary	3.4	0.2	+ 4.2	+ 3.4	+ 2.2	+ 4.0	+ 4.3	+ 2.6
Poland	3.1	0.9	+ 3.3	+ 3.8	+ 3.0	+ 4.6	+ 4.7	+ 3.2
USA	6.8	15.3	+ 2.5	+ 2.9	+ 1.6	+ 2.2	+ 2.7	+ 1.8
Switzerland	5.3	0.4	+ 2.4	+ 1.2	+ 1.4	+ 1.1	+ 3.0	+ 2.0
China	2.6	18.2	+ 7.3	+ 6.9	+ 6.7	+ 6.9	+ 6.5	+ 6.1
Total ³								
PPP-weighted ⁴		50	+ 3.8	+ 4.0	+ 3.5	+ 3.9	+ 3.9	+ 3.4
Export weighted ⁵	84		+ 2.1	+ 2.4	+ 2.1	+ 2.4	+ 2.4	+ 1.9
Market growth ⁶			+ 4.0	+ 3.8	+ 3.4	+ 6.4	+ 5.8	+ 4.6
<i>Forecast assumptions</i>								
Crude oil prices								
Brent, \$ per barrel			99.0	52.5	43.7	54.3	74	75
Exchange rate								
\$ per €			1.329	1.110	1.107	1.129	1.19	1.15
Key interest rate								
ECB main refinancing rate ⁷ , percent			0.2	0.1	0.0	0.0	0.0	0.1
10-year government bonds yields Germany, percent			1.2	0.5	0.1	0.3	0.4	0.7

Source: WIFO. 2018 and 2019: forecast. – ¹ PPP-weighted. – ² Czech Republic, Hungary, Poland, Slovenia, Slovakia. – ³ EU, USA, Switzerland, China. – ⁴ Weighted by GDP at purchasing power parities in 2017. – ⁵ Weighted by shares of Austrian goods exports in 2017. – ⁶ Real import growth of trading partners, weighted by shares of Austrian goods exports. – ⁷ Minimum bid rate.

4. External stimulus fading, but internal demand stabilising the euro area economy

The strong pace of euro area economic growth seen during 2017 slowed from the beginning of 2018. Throughout 2017, real GDP rose by 0.7 percent quarter-on-quarter, moderating to only 0.4 percent each in the first and second quarter of 2018. Retarding forces came from the external sector. Real exports fell by 0.7 percent in the first

quarter of 2018 from the previous period, before recovering +0.6 percent from April to June. Since imports rose relatively faster, the external contribution to GDP growth was once again negative.

The slackening of foreign demand was reflected by industrial production. From early 2018, the output index for the euro area declined and by July no longer exceeded the year-earlier level. Surveys among industrial firms from recent months point towards temporary stabilisation; WIFO therefore expects the downward trend to resume only from 2019.

Table 3: Fiscal and monetary policy – key figures

	2014	2015	2016	2017	2018	2019
	As a percentage of GDP					
<i>Fiscal policy</i>						
General government financial balance ¹	- 2.7	- 1.0	- 1.6	- 0.8	- 0.1	0.2
General government primary balance	- 0.3	1.3	0.5	1.0	1.5	1.7
General government total revenue	49.7	50.1	48.7	48.4	48.0	47.6
General government total expenditure	52.4	51.1	50.3	49.2	48.1	47.4
	Percent					
<i>Monetary policy</i>						
Three-month interest rate	0.2	- 0.0	- 0.3	- 0.3	- 0.3	- 0.2
Long-term interest rate ²	1.5	0.7	0.4	0.6	0.7	1.0

Source: WIFO. 2018 and 2019: forecast. – ¹ According to Maastricht definition. – ² 10-year central government bonds (benchmark).

Overall output in the euro area is currently sustained by internal demand. For Germany in particular, the Ifo Business Climate Index for August shows a significant increase in business confidence for the first time again. Driven by construction and services, both the assessment of the current situation and expectations for the next three months have brightened. Demand for construction services and private consumption, backed by a sustained improvement of labour market conditions, should therefore stabilise aggregate demand. We expect GDP for Germany to grow by 1.9 percent in 2018, moderating to +1.6 percent in 2019.

Monetary policy for the euro area remains expansionary. While headline inflation is now slightly above the ECB target (+2.1 percent according to preliminary estimates for September), core inflation, i.e., excluding the prices for unprocessed food and the strongly increased energy prices, remains close to an annual rate of 1 percent. Fiscal policy in the euro area is likely to keep a neutral stance, with automatic stabilisers making for a further narrowing of budget deficits. We expect euro area real GDP to reach +2 percent in 2018, moderating to +1.6 percent in 2019.

5. Growth in East-central Europe reaching capacity limits

The East-central European economies also benefitted from the revival of the international business cycle, thereby catching up further with the EU 15. The important markets for Austrian companies of the CEEC 5 (Poland, Hungary, Slovakia, Slovenia and Czech Republic) achieved GDP growth of 2.8 percent in 2016, almost 1 percentage point higher than in the euro area; in 2017, the rate of 4.4 percent was almost twice as high (euro area +2.4 percent). Also for the current year, WIFO expects buoyant growth of 4.2 percent.

Further expansion of the CEEC 5 economies should thereby become increasingly constrained by capacity limits. EU business surveys show capacity utilisation in Hungary, Slovenia and Slovakia to match the peak rates attained during the boom of 2007 and in Poland to be even higher. In the Czech Republic, capacity utilisation is still somewhat lower, as constraints seem to derive more from the labour market side: the unemployment rate of 2.5 percent in August was the lowest in the whole EU, followed by Germany and Poland with rates of 3.4 percent each. For 2019, WIFO therefore expects a marked deceleration of GDP growth in the CEEC 5 to an average rate of 2.9 percent.

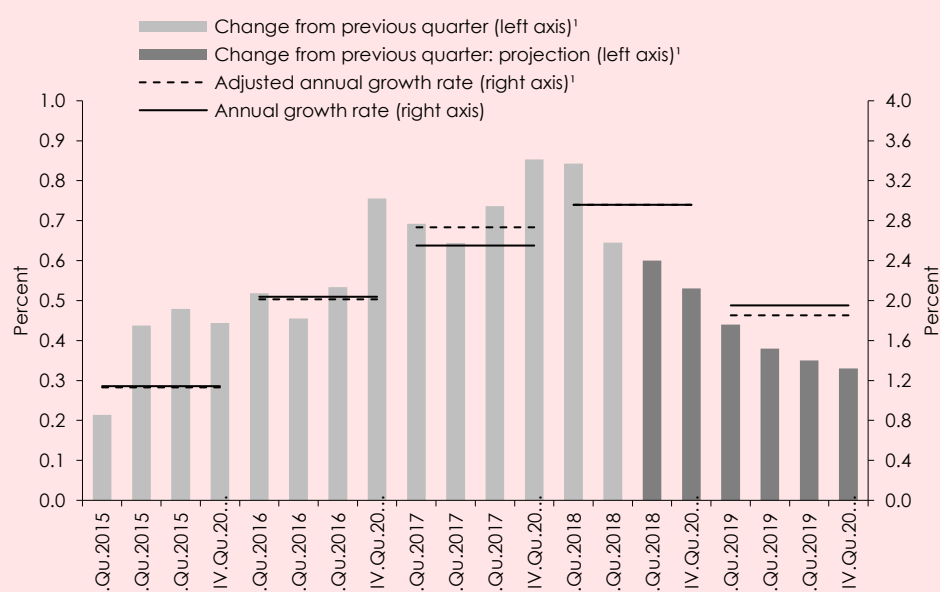
6. Business activity losing momentum in Austria

Annual GDP growth in Austria accelerated from 2.0 percent in 2016 to 2.6 percent in 2017 and, on our expectations, will strengthen further to 3.0 percent in 2018. The quarterly profile suggests that the growth cycle passed its peak around the turn of 2017-18 and is slightly heading down since. For the euro area on average, the shortfall of foreign demand has led to a more pronounced slowdown.

As anticipated in June 2018, world demand and output have slackened during the year. While the Austrian economy has held up surprisingly well to the clouding external environment, it will nevertheless not be able to permanently resist the adverse external trend.

Figure 5: Cyclical profile Austria

GDP, volume



Source: WIFO. – ¹ Trend-cycle component.

Table 4: Technical breakdown of the real GDP growth forecast

		2016	2017	2018	2019
Growth carry-over ¹	percentage points	+ 0.7	+ 0.9	+ 1.2	+ 0.9
Growth rate during the year ²	percent	+ 2.3	+ 3.0	+ 2.6	+ 1.5
Annual growth rate	percent	+ 2.0	+ 2.6	+ 3.0	+ 2.0
Adjusted annual growth rate ³	percent	+ 2.0	+ 2.7	+ 3.0	+ 1.9
Calendar effect ⁴	percentage points	+ 0.2	- 0.4	± 0.0	+ 0.1

Source: WIFO. 2018 and 2019: forecast. – ¹ Impact of year-earlier growth dynamics on growth in the current year. Equals the annual growth rate in the current year, if the level of GDP in the current year remains constant from the fourth quarter of the previous year; trend-cycle component. – ² Reflects the growth dynamics during a calendar year. Equals the year-on-year growth rate for the fourth quarter; trend-cycle component. – ³ Trend-cycle component. – ⁴ Impact of the annual number of working days and the leap day.

Higher exports and industrial output as well as survey results confirm the resilience of business confidence. In the current cyclical upswing, the Austrian economy responded rather late to the brightening external conditions. The euro area as a whole enjoyed GDP growth of 2.1 percent already in 2015, while Austria recorded only +1.1 percent in the same year. With a rate of 2.0 percent in 2016, Austria caught up with the euro area average (+1.9 percent) and slightly surpassed it in 2017 (+2.6 percent against +2.4 percent). In 2018, Austria's GDP growth of 3.0 percent will exceed the euro area by a full percentage point, confirming the time lag of the domestic business cycle. In 2019, the growth advantage is expected to narrow (+2.0 percent projected for Austria and +1.6 percent for the euro area).

Table 5: Gross value added

At basic prices

	2016	2017	2018	2019	2016	2017	2018	2019
	Billion € (reference year 2010)				Percentage changes from previous year			
<i>Volume (chain-linked series)</i>								
Agriculture, forestry and fishing	4.15	4.28	4.32	4.32	+ 2.7	+ 3.1	+ 1.0	± 0.0
Manufacturing including mining and quarrying	58.49	61.26	65.06	67.14	+ 3.3	+ 4.7	+ 6.2	+ 3.2
Electricity, gas and water supply, waste management	9.05	9.72	10.11	10.31	+ 7.9	+ 7.4	+ 4.0	+ 2.0
Construction	16.03	16.52	16.88	17.14	+ 0.4	+ 3.1	+ 2.2	+ 1.5
Wholesale and retail trade	35.91	36.29	36.95	37.54	+ 1.2	+ 1.1	+ 1.8	+ 1.6
Transportation	15.55	16.02	16.74	17.15	+ 1.9	+ 3.0	+ 4.5	+ 2.5
Accommodation and food service activities	13.32	13.50	13.77	13.95	+ 2.4	+ 1.4	+ 2.0	+ 1.3
Information and communication	9.89	10.15	10.50	10.71	+ 3.5	+ 2.6	+ 3.5	+ 2.0
Financial and insurance activities	11.98	12.39	12.84	13.13	- 1.3	+ 3.4	+ 3.7	+ 2.2
Real estate activities	26.22	26.57	27.13	27.62	+ 1.4	+ 1.3	+ 2.1	+ 1.8
Other business activities ¹	27.41	28.36	29.58	30.47	+ 3.0	+ 3.5	+ 4.3	+ 3.0
Public administration ²	48.74	49.36	49.95	50.55	+ 1.4	+ 1.3	+ 1.2	+ 1.2
Other service activities ³	7.75	7.74	7.78	7.82	- 1.3	- 0.1	+ 0.5	+ 0.5
Total gross value added ⁴	284.25	291.77	300.95	307.06	+ 2.0	+ 2.6	+ 3.1	+ 2.0
Gross domestic product at market prices	318.62	326.75	336.39	342.95	+ 2.0	+ 2.6	+ 3.0	+ 2.0

Source: WIFO. 2018 and 2019: forecast. – ¹ Professional, scientific and technical activities; administrative and support service activities (NACE M and N). – ² Including defence, compulsory social security, education, human health and social work activities (NACE O to Q). – ³ Arts, entertainment and recreation; other service activities; activities of households (NACE R to U). – ⁴ Before deduction of subsidies and attribution of taxes on products.

Table 6: Productivity

	2014	2015	2016	2017	2018	2019
	Percentage changes from previous year					
<i>Total economy</i>						
Real GDP	+ 0.7	+ 1.1	+ 2.0	+ 2.6	+ 3.0	+ 2.0
Hours worked ¹	+ 0.3	- 0.4	+ 2.1	+ 1.6	+ 2.2	+ 1.2
Productivity ²	+ 0.4	+ 1.6	- 0.0	+ 0.9	+ 0.7	+ 0.7
Employment ³	+ 1.0	+ 0.7	+ 1.4	+ 1.7	+ 1.8	+ 1.2
<i>Manufacturing</i>						
Production ⁴	+ 2.2	+ 1.3	+ 3.5	+ 4.8	+ 6.2	+ 3.2
Hours worked ⁵	- 0.2	- 0.1	+ 0.4	+ 1.5	+ 2.0	+ 0.3
Productivity ²	+ 2.4	+ 1.5	+ 3.1	+ 3.2	+ 4.1	+ 2.9
Employees ⁶	+ 0.1	+ 0.5	+ 0.6	+ 1.6	+ 2.3	+ 0.6

Source: WIFO. 2018 and 2019: forecast. – ¹ Total hours worked by persons employed, National Accounts definition. – ² Production per hour worked. – ³ Employees and self-employed, National Accounts definition (jobs). – ⁴ Gross value added, volume. – ⁵ Total hours worked by employees. – ⁶ National Accounts definition (jobs).

6.1 Weaker exports in 2019

2018 has still seen a lively expansion of Austria's foreign trade in goods, although the pace already subsided from the first half of the year. Quarterly growth rates of 1.5 percent in the third and 1.8 percent in the fourth quarter 2017 (volumes, against the previous period) declined to 1.2 percent respectively in the first and second quarter 2018. Growth nevertheless proved more robust than in the euro area overall and in Germany, where exports actually fell in the first quarter. Economic output is likely to have been solid also in the third quarter, as witnessed by employment figures and business surveys. The latest round of the WIFO-Konjunkturtest (business cycle survey) in September 2018 shows manufacturers' expectations having remained stable from May 2018. Since firms have also broadly maintained their assessment of export orders, foreign deliveries should stay high until the end of the year.

For 2019 however, WIFO expects a slackening of demand. Merchandise exports are projected to increase by only 4.5 percent in volume terms, including services by

3.7 percent. The corresponding rates for 2018 are +5.6 percent and +4.9 percent respectively.

Table 7: Expenditure on GDP

Volume (chain-linked series)

	2016	2017	2018	2019	2016	2017	2018	2019
	Billion € (reference year 2010)				Percentage changes from previous year			
Final consumption expenditure	227.84	231.14	234.68	238.05	+ 1.5	+ 1.4	+ 1.5	+ 1.4
Households ¹	164.56	166.93	169.94	172.83	+ 1.4	+ 1.4	+ 1.8	+ 1.7
General government	63.30	64.22	64.75	65.22	+ 1.8	+ 1.5	+ 0.8	+ 0.7
Gross capital formation	77.70	82.05	86.90	89.31	+ 4.2	+ 5.6	+ 5.9	+ 2.8
Gross fixed capital formation	74.23	77.14	79.75	81.93	+ 4.3	+ 3.9	+ 3.4	+ 2.7
Machinery and equipment ²	26.39	27.59	28.89	30.05	+ 10.6	+ 4.6	+ 4.7	+ 4.0
Construction	32.14	33.28	34.04	34.55	+ 0.4	+ 3.5	+ 2.3	+ 1.5
Other investment ³	15.85	16.44	17.03	17.59	+ 3.6	+ 3.7	+ 3.6	+ 3.3
Domestic demand	307.07	315.37	323.04	328.84	+ 2.4	+ 2.7	+ 2.4	+ 1.8
Exports	179.49	187.86	197.01	204.31	+ 2.7	+ 4.7	+ 4.9	+ 3.7
Travel	13.46	13.86	14.13	14.25	+ 2.3	+ 2.9	+ 1.9	+ 0.9
Minus Imports	167.86	176.44	183.50	189.99	+ 3.4	+ 5.1	+ 4.0	+ 3.5
Travel	6.70	7.27	7.63	7.89	+ 2.7	+ 8.6	+ 4.9	+ 3.4
Gross domestic product	318.62	326.75	336.39	342.95	+ 2.0	+ 2.6	+ 3.0	+ 2.0
Value	356.24	369.90	387.36	403.21	+ 3.5	+ 3.8	+ 4.7	+ 4.1

Source: WIFO. 2018 and 2019: forecast. – ¹ Including non-profit institutions serving households. – ² Including weapon systems. – ³ Mainly intellectual property products (research and development, computer programmes, copyrights).

6.2 Gross fixed capital formation on a downward trend

Demand for gross fixed capital formation, which in 2016 had expanded by 4.3 percent and in 2017 by 3.9 percent in real terms, will ease further in 2018 and 2019. Our projections are for gains of 3.4 percent and 2.7 percent respectively. Investment in machinery and equipment should prove comparatively resilient, growing by 4.7 percent in 2018 and 4.0 percent in 2019. Spending on construction, however, may expand by a moderate 2.3 percent in 2018 and 1.5 percent in 2019, following the strong +3.5 percent in 2017. Overall, gross fixed capital formation will nevertheless act as a stabilising force in the imminent cyclical downturn.

6.3 Private consumption heading further up

Inflation in Austria is currently driven by rising energy prices. In August, the CPI increased by 2.2 percent year-on-year, after +2.1 percent in July. Over the entire projection period, WIFO expects inflation to remain at a stable annual rate of 2.1 percent, unchanged from 2017.

Compensation of employees should post a gain of 4.8 percent in 2018, significantly up from the +3.4 percent of 2017, thanks to rising employment and higher wage settlements. The nominal increase of +2.5 percent on a per-capita basis is also stronger than one year ago. Unlike in 2017 and despite lively job creation, net real wages will edge up slightly in 2018, both per-capita and per work-hour, to be followed by a more substantial increase in 2019.

The continued improvement on the labour market, with rising employment and receding unemployment, raised households' readiness to spend. According to the regular survey conducted by the European Commission, consumer confidence remains above the longer-term average. After a decline from its peak of last April, the indicator rebounded in September. Consumer optimism is mirrored by the pick-up in consumption growth from 1.4 percent in 2017 to 1.8 percent in 2018. At the same time, income gains leave scope for a slight increase in the household saving rate, from 6.8 percent in 2017 to 7.0 percent in 2018.

Despite the cyclical downswing, private consumption growth should remain virtually unabated in 2019, at a projected 1.7 percent. Apart from the favourable trend of labour earnings, early effects from the introduction of the "family bonus" should provide fresh stimulus to consumption as from the second half of the current year.

Growth of wages and salaries exceeds the inflation rate in 2018, enabling an increase in private consumption. The benign labour market situation raises the spending propensity of households.

Table 8: Private consumption, income and prices

	2014	2015	2016	2017	2018	2019
	Percentage changes from previous year, volume					
Private consumption expenditure ¹	+ 0.3	+ 0.4	+ 1.4	+ 1.4	+ 1.8	+ 1.7
Durable goods	- 0.3	+ 1.9	+ 3.0	+ 0.5	+ 1.0	+ 0.5
Non-durable goods and services	+ 0.4	+ 0.3	+ 1.2	+ 1.5	+ 1.9	+ 1.8
Household disposable income	+ 0.7	- 0.2	+ 2.5	+ 0.5	+ 2.0	+ 1.6
	As a percentage of disposable income					
Household saving ratio						
Including adjustment for the change in pension entitlements	7.3	6.8	7.8	6.8	7.0	6.9
Excluding adjustment for the change in pension entitlements	6.7	6.1	7.1	6.2	6.4	6.3
	Percentage changes from previous year					
Loans to domestic non-banks (end of period)	+ 0.1	+ 1.8	+ 1.8	+ 0.9	+ 2.9	+ 1.8
	Percent					
Inflation rate						
National	1.7	0.9	0.9	2.1	2.1	2.1
Harmonised	1.5	0.8	1.0	2.2	2.2	2.2
Core inflation ²	1.9	1.7	1.5	2.2	2.0	2.2

Source: WIFO. 2018 and 2019: forecast. – ¹ Private households including non-profit institutions serving households. – ² Excluding energy and unprocessed food (meat, fish, fruits, vegetables).

Table 9: Earnings, international competitiveness

	2014	2015	2016	2017	2018	2019
	Percentage changes from previous year					
Wages and salaries per employee ¹						
Nominal, gross	+ 1.7	+ 2.0	+ 2.3	+ 1.4	+ 2.5	+ 2.4
Real ²						
Gross	- 0.0	+ 1.1	+ 1.4	- 0.7	+ 0.4	+ 0.3
Net	- 0.6	+ 0.6	+ 4.3	- 0.9	+ 0.2	+ 0.4
Wages and salaries per hour worked ¹						
Real, net ²	- 0.2	+ 2.0	+ 3.6	- 0.8	+ 0.1	+ 0.6
	Percent					
Wage share, adjusted ³	68.5	69.3	68.4	67.9	67.4	66.9
	Percentage changes from previous year					
Unit labour costs, nominal ⁴						
Total economy	+ 1.9	+ 1.7	+ 1.6	+ 0.6	+ 1.5	+ 1.8
Manufacturing	+ 0.2	+ 0.9	- 0.5	- 1.2	- 0.8	+ 0.2
Effective exchange rate – manufactured goods ⁵						
Nominal	+ 1.2	- 2.9	+ 1.2	+ 0.7	+ 1.7	- 0.5
Real	+ 1.5	- 2.9	+ 1.3	+ 1.0	+ 1.6	- 0.7

Source: WIFO. 2018 and 2019: forecast. – ¹ National Accounts definition. – ² Deflated by CPI. – ³ Compensation of employees as a percentage of national income, adjusted for the change in the share of employees in total employment from base year 1995. – ⁴ Labour costs in relation to productivity (hourly compensation per employees divided by GDP per employed persons' hours worked). – ⁵ Weighted by exports and imports, real value adjusted by relative HCPI.

6.4 Employment rises again strongly, keeping unemployment on a falling trend

Lively business activity gives impetus to job creation, which reaches a new high in 2018 with 88,000 additional persons in active dependent employment, compared with +71,000 last year. Since the beginning of the cyclical upswing in 2016, employment has increased by 210,000. With a projected +55,000, job creation may move to a somewhat slower pace in 2019. Over the whole forecast period, the number of foreign workers will rise more strongly than domestic employment.

In accordance with brighter job opportunities, the fall in unemployment is gaining momentum. The number of registered jobseekers will drop by 28,000 or 8.2 percent this year, after –17,300 (–4.9 percent) in 2017. During 2018, the year-on-year decline has nevertheless narrowed, as fewer jobseekers have left the records while been enrolled in formal job training: their number had increase by around 5,000 in 2017, but fell by 4,000 in 2018. In 2019, unemployment should decline by a projected 12,000 persons, or by 20,000 when trainees are included.

The unemployment rate, calculated according to national definitions, eases from 8.5 percent of the dependent labour force in 2017 to 7.7 percent in 2018 and 7.3 percent in 2019. On international standard definitions, it edges down from 5.5 percent (of the total labour force) in 2017 to 4.8 percent in 2018 and 4.5 percent in 2019.

Table 10: Labour market

	2014	2015	2016	2017	2018	2019
	Change from previous year in 1,000					
<i>Demand for labour</i>						
Persons in active employment ¹	+ 31.8	+ 42.5	+ 62.3	+ 76.4	+ 93.0	+ 60.0
Employees ^{1,2}	+ 23.8	+ 33.2	+ 53.7	+ 70.7	+ 88.0	+ 55.0
National employees	– 8.1	+ 6.3	+ 17.7	+ 23.8	+ 32.0	+ 18.0
Foreign employees	+ 32.0	+ 27.0	+ 36.0	+ 46.8	+ 56.0	+ 37.0
Self-employed ³	+ 8.0	+ 9.3	+ 8.6	+ 5.7	+ 5.0	+ 5.0
<i>Labour supply</i>						
Population of working age						
15 to 64 years	+ 33.1	+ 52.3	+ 65.8	+ 23.0	+ 16.2	+ 13.7
Labour force ⁴	+ 64.0	+ 77.5	+ 65.3	+ 59.0	+ 65.0	+ 48.0
<i>Labour surplus</i>						
Unemployed ⁵	+ 32.2	+ 35.0	+ 3.0	– 17.3	– 28.0	– 12.0
Unemployed persons in training	+ 1.8	– 10.2	+ 2.1	+ 4.9	– 4.0	– 8.0
	Percent					
<i>Unemployment rate</i>						
As a percentage of total labour force (Eurostat) ⁶	5.6	5.7	6.0	5.5	4.8	4.5
As a percentage of total labour force ⁵	7.4	8.1	8.1	7.6	6.9	6.5
As a percentage of dependent labour force ⁵	8.4	9.1	9.1	8.5	7.7	7.3
	Percentage changes from previous year					
Labour force ⁴	+ 1.5	+ 1.8	+ 1.5	+ 1.4	+ 1.5	+ 1.1
Persons in active dependent employment ^{1,2}	+ 0.7	+ 1.0	+ 1.6	+ 2.0	+ 2.5	+ 1.5
Unemployed ⁵	+ 11.2	+ 11.0	+ 0.8	– 4.9	– 8.2	– 3.8
Persons (in 1,000)	319.4	354.3	357.3	340.0	312.0	300.0

Source: WIFO. 2018 and 2019: forecast. – ¹ Excluding persons in valid employment contract receiving child care benefit or being in military service. – ² According to the Organisation of Austrian Social Security. – ³ According to WIFO, including liberal professions and unpaid family workers. – ⁴ Persons in active employment plus unemployed. – ⁵ According to Public Employment Service Austria. – ⁶ Labour Force Survey.

7. The risk environment

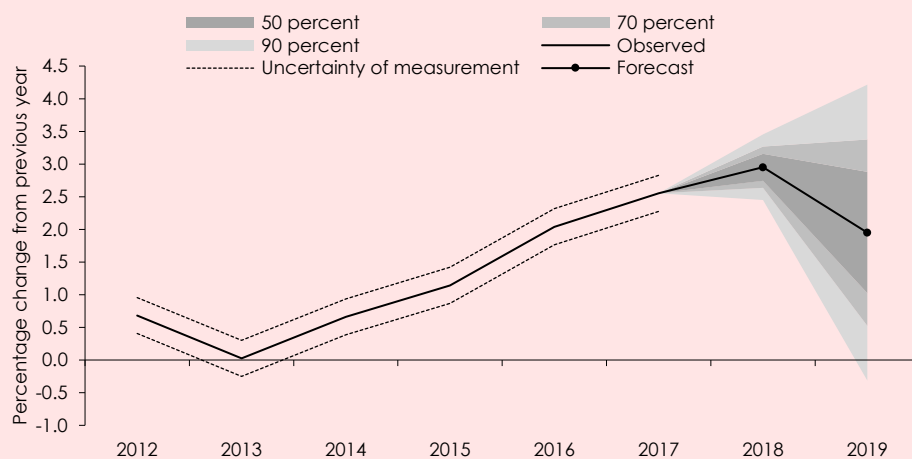
Next to the projection of the most likely course of events (baseline scenario), an assessment of qualitative and quantitative risks is a key element in any forecast. This not only concerns the external assumptions like the reference price for internationally-traded oil or the dollar exchange rate, but also other imponderables surrounding the point estimates. Hence, the present forecast for GDP growth also presents margins of uncertainty (Figure 6).

At this juncture, the major risk relates to the external business environment. As long as there is no political agreement on the terms of Brexit, its potential repercussions are difficult to predict. A "hard Brexit" without any agreement would undoubtedly hit international trade and hence the Austrian economy more severely than a consensual settlement close to present arrangements. Also the tariff disputes between the USA and a number of countries are adding to uncertainty. Should the currency turbulence currently confined to some emerging markets spill over to other geographical areas, the implicit forecast risks would rise as well. A further risk element concerns public finances in Italy. In its latest budgetary plan, the Italian government has deliberately

While the likelihood for annual GDP growth to pick up in 2019 seems weak, there is more uncertainty about the scope of the expected slow-down.

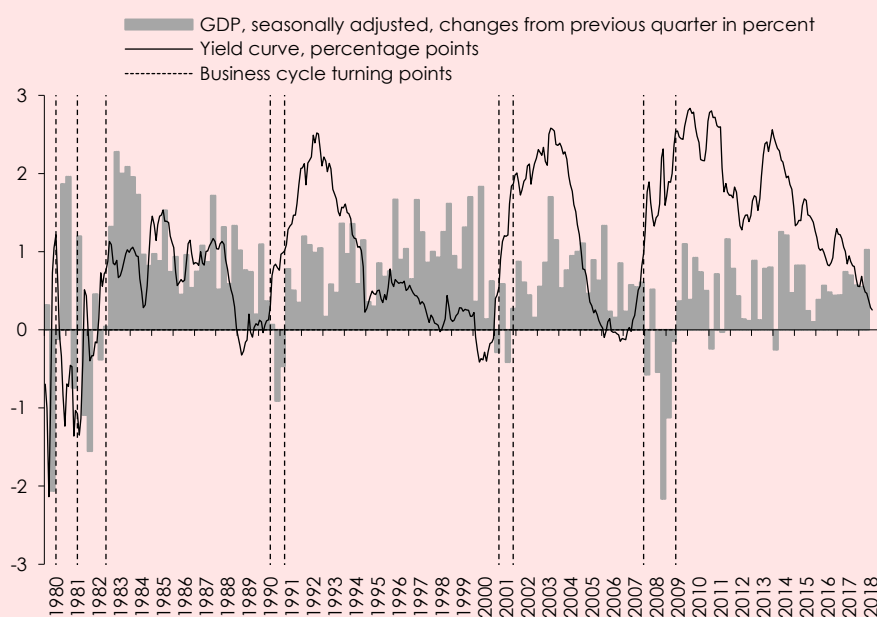
deviated from earlier-promised consolidation targets by heading for a higher deficit of 2.4 percent of GDP in 2019. Although financial markets have already reacted by widening interest rate spreads on Italian bonds, their yields are still markedly lower than during the financial market crisis around the turn of 2011-12. Should returns continue to rise, it may again require actions of financial support from other euro area countries, which however would be many times higher than the one granted to Greece.

Figure 6: Margins of uncertainty for GDP, CPI and unemployment rate



Source: WIFO. Margins of uncertainty calculated on the basis of ex-post revealed forecast errors.

Figure 7: Yield curve and business cycle turning points in the USA



Source: Bureau of Economic Analysis, Federal Reserve Board, NBER, Macrobond. Yield curve: Spread between interest rates on 10-year and 2-year US government bonds.

The risks to the forecast of GDP growth in 2018 are narrowly circumscribed. Those for 2019 are mainly on the downside. In particular, a recession in the USA would adversely affect developments in the euro area at large and in Austria. A negative yield differential between US government bonds of 10- vs. 2-year maturity (yield curve) has shown to be a clear indication of an imminent cyclical downturn (Figure 7). At present, the spread is still positive. Moreover, past experience suggests that a swing into

negative territory leads to a recession after about one year. WIFO therefore rates the probability of a recession setting in already in 2019 as low.

On the other hand, demand and output growth may abate less than projected by the baseline scenario. Should the European economy, benefitting from a persistently expansionary monetary policy, succeed in developing an autonomous business cycle based on domestic forces, the hitherto solid pace of private consumption and investment may possibly even accelerate.