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UNEMPLOYMENT TO DECLINE AS ECONOMIC ACTIVITY PICKS UP

ECONOMIC OUTLOOK FOR 1999 AND 2000

The present business cycle picture is closely in line with the last WIFO short-term projections. Industrial output has been recovering from its trough early this year. The forecast for overall GDP growth remains unchanged. Developments on the labour market have been better than expected. For the first time in five years, unemployment will recede markedly in 1999, due in particular to strong domestic demand, but also to a reinforcement of employment policy measures.

The Austrian economy is projected to grow by 2.2 percent in 1999 and by 2.6 percent in 2000, unchanged from the last revision in March. Exports and industrial output fell to a low at the beginning of this year, but business confidence has improved since. The WIFO business survey in June confirms the pick-up in industrial activity and the growing optimism among entrepreneurs for the second half of the year.

In the EU also, and notably in Germany, business sentiment has strengthened in recent months. A major factor has been the gradual stabilisation of the economies in South-East Asia. The weakening of the euro is also supportive to a better export outlook. Yet, risks for a renewed outbreak of financial crises remain.

Signs of an upturn have been observed in Austria as well as in the euro zone as a whole in the first quarter, with GDP rising 0.4 percent (from the previous period, seasonally adjusted), respectively. The year-on-year advance was 1.8 percent for the euro zone and 1.1 percent for Austria where it was depressed by a weather-induced fall in construction output.

Slower export growth this year will be offset by lively domestic demand. Net real disposable income of households is projected to gain strongly, nearly 3 percent, due to stable import prices and higher employment. Next year, the effects of the tax reform will further add to purchasing power and give strong momentum to private consumption. Business investment does not appear to be severely affected either by the temporary slowdown in exports, judging from recent survey data and from imports of capital goods. These trends confirm earlier expectations for the Austrian economy and, thus, the WIFO projections of last March for GDP growth remain unchanged.

All staff members of the Austrian Institute of Economic Research contribute to the Economic Outlook.

Table 1: Main results

		1996	1997	1998	1999	2000
		Percentage changes from previous year				
GDP						
Volume		+ 2.0	+ 2.5	+ 3.3	+ 2.2	+ 2.6
Value		+ 3.7	+ 4.1	+ 4.3	+ 3.1	+ 3.6
Manufacturing[1], volume		+ 1.2	+ 5.0	+ 4.4	+ 2.0	+ 3.8
Private consumption, volume		+ 2.0	+ 0.7	+ 1.7	+ 2.0	+ 2.4
Gross fixed investment, volume		+ 2.5	+ 2.8	+ 4.7	+ 3.8	+ 3.6
Machinery and equipment		+ 3.3	+ 5.0	+ 7.8	+ 6.5	+ 6.5
Construction		+ 2.4	+ 1.3	+ 2.6	+ 1.5	+ 1.0
Exports of goods[2]						
Volume		+ 5.4	+15.6	+ 8.4	+ 4.5	+ 7.0
Value		+ 5.5	+16.8	+ 8.4	+ 4.5	+ 8.0
Imports of goods[2]						
Volume		+ 6.1	+ 9.4	+ 8.2	+ 5.0	+ 6.7
Value		+ 6.7	+10.9	+ 6.6	+ 5.0	+ 7.7
Trade balance[2]	billion ATS	–100.6	–75.2	–67.4	–74.6	–77.9
	billion euro				– 5.4	– 5.7
Current balance	billion ATS	– 50.8	–61.4	–54.5	–60.0	–60.1
	billion euro				– 4.4	– 4.4
	as a percentage of GDP	– 2.1	– 2.4	– 2.1	– 2.2	– 2.1
Long-term interest rate[3]	in percent	6.3	5.7	4.7	4.1	4.4
Consumer prices		+ 1.9	+ 1.3	+ 0.9	+ 0.6	+ 1.0
Unemployment rate						
	percent of total labour force[4]	4.3	4.4	4.7	4.4	4.2
	percent of dependent labour force[5]	7.0	7.1	7.2	6.8	6.6
Dependent employment[6]		– 0.6	+ 0.4	+ 1.0	+ 1.0	+ 0.8

[1] Value added, including mining and quarrying. – [2] According to Austrian Central Statistical Office. – [3] 10-year central government bonds (benchmark). – [4] According to Eurostat. – [5] According to Labour Market Service. – [6] Excluding parental leave and military service.

Meanwhile, the labour market outlook has turned more positive: employment is set to increase by around 30,000 this year, and unemployment to fall by 10,000. Two-fifths of this drop is explained by temporary measures of labour market policy ("job coaching"), the larger part by more jobs being offered in services due to the strength of domestic demand. With the recovery gaining ground, unemployment should decline further next year, to a rate of 4.2 percent of the labour force.

Under the impact of falling import prices and stable unit labour costs, inflation has further decelerated. In 1999, consumer prices may edge up by an annual rate of 0.6 percent, followed by 1 percent next year, assuming an upturn in world market commodity prices. Not only firms, but also households are benefiting from the liberalisation of telecommunication and electricity networks. Wages are expected to advance at a very moderate pace, given the heightened competitive pressure within the EU and an earnings squeeze in manufacturing industry, where wage settlements usually provide the yardstick for other sectors of the economy. Both in industry and construction, profit as well as labour market conditions have turned less favourable in 1999.

The slack in export demand will push up the trade deficit in 1999, while a higher net surplus on tourism services should act as a partial offset. A further drag on the current external account is exerted by the strongly negative balance of factor incomes. The latter is not a sign of insufficient international competitiveness, but rather a result of the attractiveness of domestic fixed-term assets (bonds) for foreign investors.

Federal government finances in 1999 will, as in the past years, strictly adhere to the budget draft. The general government net borrowing will slightly exceed 2 percent of GDP, broadly unchanged from 1998. In 2000, the budgetary situation will become considerably strained, as a consequence of the large-scale tax reform. The targeted deficit ratio of 2.5 percent will be attained only under the assumption of authorities keeping spending firmly under control. Given the sizeable tax cuts and additional family benefits provided for, a better budget outturn may be achieved only if general business activity were to be markedly stronger than anticipated. In order to avoid another recourse to more drastic consolidation "packages", fiscal policy will have to maintain a stance of pronounced expenditure restraint over several years to come.

INTERNATIONAL ENVIRONMENT TURNING BRIGHTER

World economic activity has strengthened in early 1999. In the USA, the strong upward momentum continued; fiscal stimulus revived the Japanese economy; and the emerging markets appear to have passed the trough of the recession. Yet, important risks and uncertainties remain.

The boom in the USA extended into the first quarter 1999, receiving continued support from private consumption, while exports slackened markedly. In the course of the year, the upward trend should flatten, possibly also due to monetary policy reacting to increasing supply constraints. Private consumption may lose momentum, particularly if higher interest rates should bring the swift rise in the stock market to an end. Financial markets are generally expecting that the Federal Reserve will raise short-term interest rates over the coming months. On the one hand, there are first signs of accelerating inflation; on the other hand, there is an increasing debate whether the Central Bank should react to the strong upward drift in asset prices (stock market).

Over the medium term, the U.S. economy is faced with the problem of high private sector indebtedness (households as well as enterprises). As share prices have risen, the pri-

Figure 1: Indicators of economic performance

[1] Vis-à-vis the euro zone. – [2] Manufacturing; in a common currency vis-à-vis trading partners. – [3] 10-year central government bonds (benchmark). – [4] Excluding parental leave and military service.

vate saving ratio has fallen to zero (from 9 percent in 1984 and 5 percent in 1990), which is hardly sustainable over a longer period. This was accompanied by a massive increase in the current account deficit.

The Japanese economy has not yet returned to self-sustained growth in the private sector. A strong advance of GDP in the first quarter was primarily the effect of large-scale public expenditure programmes. A lasting recovery is not yet assured.

In several countries in South-East Asia, economic activity has started to rebound. Since the financial crisis in the region has had a dampening impact on Europe, recovery from the crisis would bode well also for the European business cycle. However, despite some brighter spots, the situation of the Emerging Markets is still surrounded by high uncertainty. The delicate balance may be easily lost in the event of renewed crisis or accidental shocks.

In Latin America, stabilisation of financial markets has been achieved at the price of a slump in growth; and in Russia the economic crisis is far from being overcome. Yet, and despite all such risks and uncertainties, most international forecasters expect the world economy to gain momentum over the next eighteen months.

Table 2: World economy

		1996	1997	1998	1999	2000
		Percentage changes from previous year				
Real GDP						
Total OECD		+ 2.7	+ 2.8	+ 2.0	+ 2.3	+ 2.0
USA		+ 3.4	+ 3.9	+ 3.9	+ 3.5	+ 2.0
Japan		+ 5.1	+ 1.4	– 2.8	– 0.5	+ 0.5
EU		+ 1.6	+ 2.5	+ 2.7	+ 2.0	+ 2.5
Euro area		+ 1.4	+ 2.4	+ 2.8	+ 2.3	+ 2.5
Germany		+ 0.8	+ 1.8	+ 2.3	+ 1.8	+ 2.5
Central Eastern Europe[1]		+ 4.7	+ 5.1	+ 3.3	+ 2.0	+ 3.0
World trade, volume		+ 6.8	+10.0	+ 4.3	+ 4.0	+ 5.5
OECD exports		+ 6.3	+11.3	+ 4.5	+ 3.5	+ 5.8
Intra-OECD trade		+ 6.0	+11.3	+ 7.3	+ 4.8	+ 5.5
Market growth[2]		+ 6.2	+ 9.4	+ 6.6	+ 4.0	+ 6.0
Primary commodity prices, in USD						
HWWA index, total, 1990 = 100		+ 4.0	– 1.0	–23.0	+ 1.0	+ 3.0
Excluding energy		– 9.0	± 0.0	–13.0	– 7.0	+ 6.0
Crude oil prices						
Average import price (cif) for OECD countries	USD per barrel	20.6	19.1	12.7	14.0	14.0
Exchange rate	USD per ECU or euro	1.270	1.134	1.121	1.04	1.10

[1] Poland, Slovakia, Slovenia, Czech Republic, Hungary. – [2] Real import growth of trading partners weighted by Austrian export shares.

Table 3: Productivity

	1996	1997	1998	1999	2000
	Percentage changes from previous year				
Total economy					
Real GDP	+2.0	+2.5	+3.3	+2.2	+2.6
Employment[1]	–0.6	+0.1	+0.9	+0.9	+0.7
Productivity (GDP per employment)	+2.6	+2.4	+2.3	+1.3	+1.8
Manufacturing					
Production[2]	+1.3	+5.3	+4.4	+2.0	+3.8
Employees	–2.9	–1.4	+0.1	–1.0	–0.3
Productivity per hour	+4.6	+6.6	+4.1	+3.5	+4.5
Working hours per day for employees	–0.3	+0.2	+0.2	–0.5	–0.4

[1] Dependent and self-employed according to National Accounts. – [2] Value added.

HEALTHY DOMESTIC DEMAND IN EUROPE

In Europe, the cycle of manufacturing output and exports appears to have bottomed out in the first quarter. In April and May, industrial confidence has started improving; data on exports and output, which could confirm such pick-up, are not yet available.

Despite a marked slowdown of exports (–1 percent), overall economic performance in the euro zone has been good in the first quarter: according to preliminary figures, GDP climbed by 1.8 percent year-on-year and by a seasonally adjusted 0.4 percent from the previous quarter.

Domestic demand has strengthened in Europe, particularly in France and Spain. Consumer confidence, having been on a steep upward trend for many months, slackened somewhat in April and May, probably due to the crisis in Kosovo. It was mainly the "general economic situation" which consumers saw with greater scepticism.

Many indicators speak in favour of an export-led recovery in the second half of this year, accelerating in 2000. For the euro zone, expectations are for 2¼ percent GDP growth in 1999, and a little more next year. The most important risk elements concern uncertainties about further developments in the USA, and potential recurrence of financial turbulence in the emerging markets.

The surprisingly strong interest rate cut by the ECB has pushed down all short-term rates. Long-term interest rates, on the other hand, softened only temporarily, before resuming their upward tendency. The cut in official rates added to the weakening of the euro: the latter, however, has so far no more than offset the gains of the second half of 1998, the current exchange rate being close to its level a year ago. For next year, a recovery of the euro exchange rate is expected, if economic growth in Europe exceeds that in the USA.

GERMAN ECONOMY TRAILING THE RECOVERY

After 1995, the recovery in Germany has now stalled for the second time. While in 1995, currency depreciation in major competitor countries has been the main reason, more recently the financial crises in South-East Asia and in Russia last year have slowed exports, Germany's "engine" of growth. Obviously, the strong export-oriented economies with a high saving ratio (Germany, Japan) are affected more than others by financial crises and subsequent demand shortfalls in the Emerging Markets with high import intensity.

So far, the German economy has not overcome the stagnation into which it fell last autumn. Manufacturing output in the first quarter 1999 edged down from the previous period (on a seasonally adjusted basis), remaining more than 1 percent below the level of the previous year. Production cuts were most marked for investment goods. Still, for the rest of the year optimism is spreading also in Germany's industry. GDP growth in 1999, projected at 1¾ percent, is likely to fall below the Euro-zone average. In 2000, the fiscal consolidation measures adopted by the Federal government may dampen the strengthening of activity to be expected from the revival of exports.

EXPORT AND INDUSTRIAL ACTIVITY GAINING MOMENTUM IN AUSTRIA

Austrian exports last year were affected by the financial crises in different parts of the world. By now, the fall in demand should have bottomed out to give way to a better outlook for a turnaround.

Table 4: Private consumption

	1996	1997	1998	1999	2000
	Percentage changes from previous year, volume				
Private consumption	+2.0	+0.7	+1.7	+2.0	+2.4
Durables	+8.1	–3.5	+0.9	+3.0	+3.5
Non-durables and services	+1.1	+1.4	+1.8	+1.9	+2.2
Net wages and salaries	–1.9	–3.1	+1.9	+2.9	+3.3
Household disposable income	–0.2	+0.2	+2.7	+2.2	+2.8
	As a percentage of disposable income				
Household saving ratio	*7.8*	*7.4*	*8.3*	*8.5*	*8.8*

Given the small gains in the first quarter, the average annual rise of exports in 1999 may not exceed 4½ percent. The fall in the euro will have a positive impact on export volumes only with a certain time lag. Therefore it may not be before 2000 that external conditions will allow exports to return to their normal pace. Underlying the projections is the assumption that financial market risks and uncertainties will effectively be kept in check. An implicit improvement in relative unit labour costs in manufacturing bodes well for gains in market shares this year and next.

Over the next months, Austrian manufacturing industry should leave the trough into which is was pushed by falling export orders last autumn. The WIFO business survey of last June shows an improvement in orders and in the more forward-looking indicators.

Manufacturing output declined year-on-year in the first quarter, albeit from a high base. The latest WIFO business survey suggests a pick-up in industrial activity for the second half of the year. Firms have on balance expressed greater confidence than before as regards orders, production outlook and the general business climate. So far, the recovery has not been confirmed by output and export figures. Employment in industry has stayed falling, according to the most recent data for May.

A recovery of output during the second semester 1999 is likely not only on the base of survey data, but also because of the stabilisation of several emerging markets and of lively internal demand in the EU. Still, the annual average increase in industrial output may not be higher than 2 percent.

ADVANCES IN PRIVATE CONSUMPTION

Confidence of consumers remained unshaken over recent months. It is supported by sizeable gains in net real household incomes. Changes in the statistical base allow no reliable comparison of retail sales to be made with those of last year, particularly as regards the analysis by categories of goods. An estimate for the first quarter would yield an increase by 3 percent, including an upward bias caused by a calendar effect (Easter holidays).

Table 5: Earnings and international competitiveness

	1996	1997	1998	1999	2000
	Percentage changes from previous year				
Gross earnings per employee	+1.9	+0.7	+2.6	+2.5	+2.5
Gross real earnings per employee	–1.0	–1.3	+1.7	+1.9	+1.5
Net real earnings per employee	–2.3	–3.8	+1.2	+1.3	+2.4
Net wages and salaries	+0.9	–1.1	+2.9	+3.5	+4.3
Unit labour costs					
Total economy	–0.7	–1.3	+0.3	+1.2	+0.7
Manufacturing	–2.0	–5.0	–1.7	–0.5	–1.5
Relative unit labour costs[1]					
Vis-à-vis trading partners	–3.2	–4.9	–0.8	–1.0	–1.0
Vis-à-vis Germany	–1.6	–0.6	+0.5	–0.5	–0.5
Effective exchange rate – manufactures					
Nominal	–1.2	–1.8	+0.6	–0.5	+0.5
Real	–1.5	–2.6	±0.0	–1.3	–0.2

[1] Manufacturing, in a common currency; minus sign indicates improvement of competitiveness.

Gains in purchasing power of private households will lead to a substantial increase in consumer expenditure this year. Next year, the pace may further accelerate under the impact of the tax reform.

Private consumption of domestic residents is set to rise by an average 2 percent in 1999, since net wages and salaries plus transfers will post strong gains. In 1999, they are projected to increase by a price-adjusted 3 percent, in 2000 by 3¼ percent. Disposable income (including the self-employed) may rise somewhat less strongly. Given these figures, the expectations for private consumption – +2 and +2.4 percent this year and next – would appear rather cautious. The savings ratio may revert its fall between 1995 and 1997 and return towards its normal level, approaching 9 percent.

Unlike in the past few years, public households will exert a distinctly expansionary impact on disposable income: family benefits will be raised by a total of ATS 12 billion, the wage and income tax reform is set to reduce the tax burden by ATS 17 billion overall.

Lively domestic demand is also mirrored by a substantial rise in imports of consumer as well as capital goods. Investment behaviour appears to be little affected by the sluggishness of exports. The latest WIFO investment survey also confirms the continued favourable climate. Firms intend to increase spending by a sizeable amount, and data for the first quarter point into the same direction. The changeover to the new millenium is expected to stimulate the installation of new software.

Much less favourable is the situation in the construction sector. From last year's level, which had been boosted by clement weather conditions, output fell sharply in the first quarter 1999, and workers were laid off. If a slight increase in production is nevertheless expected for the year as a whole, it is mainly due to lively demand for renovation and some carrying-forward of maintenance works (tax privileges for rent reserves will expire at the end of 1999). In 2000, renovation activity is set to subside, and building of new homes may stay on a downward trend. In spite of generous subsidies, demand for rented and communal apartments is slack; somewhat better is the market for owned apartments and single-family homes. Civil engineering is recovering from the slump in public orders caused by budgetary restrictions, and a number of large projects to build new office space are being launched (notably in Vienna).

WIDENING CURRENT ACCOUNT DEFICIT

In 1998, the current account showed a deficit of ATS 54.5 billion, some ATS 7 billion less than the year before. The improvement was mainly owed to a higher net surplus on tourism revenues. In addition, the trade balance was alleviated by the sharp drop in crude oil prices and an improvement in price competitiveness.

This year, developments may reverse: the commodities' balance will likely deteriorate. With imports propelled by lively domestic demand and exports subdued this will bring about a widening of the trade deficit. The balance of factor incomes may weaken for the second year in a row. This, however, is no sign of weak competitiveness of the Austrian economy, but is explained by the high attractiveness of domestic bonds for foreign investors.

The surplus on cross-border tourism services should increase further in 1999 and 2000. During the winter season 1998-99, tourism turnover gained around 6 percent year-on-year, according to preliminary figures. The positive trend is likely to extend into the summer season. However, in 2000, the propensity of German customers to travel and spend abroad may be constrained by domestic measures of budgetary consolidation taking effect.

INFLATION ACCELERATING ONLY SLIGHTLY

In early 1999, the rise in consumer prices has further abated. In April, the rate of inflation fell to 0.2 percent. The major factors behind the stable price climate are declining import prices and moderate wage increases.

In the first quarter, the wholesale price index, which more accurately reflects international price movements, was 2 percent below the previous year. A fall in prices was recorded for items directly or indirectly affected by the Asian crisis (steel, metals, crude oil, electronics).

For the time being, however, the price decline for internationally traded goods has come to a standstill. Increasing prices for crude oil and other raw materials have pushed the inflation rate in May back to 0.5 percent, the average rate for 1999 is projected at 0.6 percent. With import prices assumed picking up, the rate of inflation in 2000 may rise to 1 percent. Stable unit labour costs (+¾ percent), price cuts for electricity of private households following market liberalisation, and subdued rent increases should have a dampening effect on overall price developments. Besides, an expected strengthening of the euro exchange rate ought to keep the rise in import prices in check.

The projected recovery of activity is unlikely to impact strongly on wage settlements this year. The latter will be negotiated under the auspices of weaker profit and labour market conditions in manufacturing industry and construction. On WIFO assumptions, effective wages and salaries per employee will advance by around 2½ percent both this year and next.

UNEMPLOYMENT RECEDING FOR THE FIRST TIME SINCE 1994

Along with the creation of a substantial number of new jobs, the rate of unemployment is set to fall both in 1999 and 2000. This year, two-fifth of this fall is accounted for by the practice of "job coaching".

Despite sluggish export growth, the number of jobs is growing strongly. While the construction sector and manufacturing industry are laying off workers, demand for additional personnel is lively in many services branches. Commercial services added 14,000 to their workforce during the first five months of 1999, health and education services some 9,000, trade, transport and hotels/restaurants 9,000.

The key element for the employment strength has been the rebound in domestic demand. Being relatively labour-intensive, an increase in domestic demand creates more than twice as many jobs as the same increase of (capital-

Table 6: Labour market

	1996	1997	1998	1999	2000
	Changes from previous year, in 1,000				
Demand for labour					
Civilian employment	–23.8	+ 8.8	+22.1	+26.0	+24.9
Dependent employment[1]	–20.9	+ 8.3	+21.1	+25.0	+24.0
Excluding parental leave and military service	–16.5	+12.8	+29.8	+29.2	+24.2
Percentage changes from previous year	– 0.6	+ 0.4	+ 1.0	+ 1.0	+ 0.8
Parental leave and military service[1]	– 4.4	– 4.4	– 8.7	– 4.2	– 0.2
Foreign workers	+ 0.0	– 1.6	– 0.2	+ 4.0	+ 1.4
Self-employed[2]	– 2.9	+ 0.5	+ 1.0	+ 1.0	+ 0.9
Labour supply					
Total labour force	– 9.0	+11.7	+26.5	+16.0	+18.7
Foreign	+ 2.8	– 1.7	+ 0.7	+ 2.0	+ 0.7
Migration of nationals	+ 4.9	+ 5.4	+ 5.5	+ 3.5	+ 2.0
Indigenous	–16.7	+ 8.0	+20.3	+10.5	+16.0
Surplus of labour					
Registered unemployed[3]	+14.8	+ 2.8	+ 4.4	–10.0	– 6.2
In 1,000	230.5	233.3	237.8	227.8	221.6
Unemployment rate					
percent of total labour force[4]	4.3	4.4	4.7	4.4	4.2
percent of total labour force[3]	6.3	6.4	6.5	6.2	6.0
percent of dependent labour force[3]	7.0	7.1	7.2	6.8	6.6
Participation rate[5]	67.2	67.2	67.6	67.7	67.9
Employment rate[6]	62.9	62.9	63.2	63.6	63.8

[1] According to Association of Austrian Social Security Bodies. – [2] According to WIFO. – [3] According to Labour Market Service. – [4] According to Eurostat. – [5] Total labour force as a percentage of active population (aged 15 to 64). – [6] Employment as a percentage of active population (aged 15 to 64).

intensive) exports. A rise in private consumption raises employment particularly in the service sector.

Last May, employment was higher by 27,400 than a year earlier, while the number of registered jobless fell by 18,400. The unemployment rate (according to the traditional way of calculation) stood at 6.1 percent, ½ percentage point lower than in May 1998.

Apart from the substantial gains in employment, two factors are responsible for the falling number of persons out of work: a slowing increase in labour supply, and a reinforcement of labour market policy measures. Labour supply is reverting to its flatter upward trend this year, having been boosted in 1998 by side-effects of budgetary consolidation (shortening of the entitlement period for paid maternity leave).

Furthermore, additional labour market policy measures ("job coaching") have contributed towards lowering the unemployment figures since May. Two-fifths of the fall in the total by 10,000 expected for the 1999 average may be accounted for by "job coaching" for a limited period of time. It reduces temporarily open unemployment and thereby also labour supply, but has no effect on employment figures. Over a period of six months, 40,000 people out of work receive job search training during six weeks. Whether this measure eventually will have served to cut the unemployment figures or whether it actually has offered a chance to jobseekers to re-insert themselves into gainful employment, remains to be seen.

Table 7: Key policy indicators

	1996	1997	1998	1999	2000
	Billion ATS				
Fiscal policy					
Central government net balance	–89.4	–67.2	–67.0	–70.0	–81.0
	As a percentage of GDP				
Central government net balance	– 3.7	– 2.7	– 2.6	– 2.6	– 2.9
General government financial balance	– 3.7	– 1.9	– 2.1	– 2.1	– 2.5
	In percent				
Monetary policy					
3-month interest rate	3.4	3.5	3.6	2.8	2.8
Long-term interest rate[1]	6.3	5.7	4.7	4.1	4.4
Bond yield, average	5.3	4.8	4.4	3.6	3.8
	Percentage changes from previous year				
Effective exchange rate					
Nominal	– 1.5	– 2.3	+ 0.6	– 0.6	+ 0.8
Real	– 2.1	– 3.3	– 0.1	– 1.5	– 0.1

[1] 10-year central government bonds (benchmark).

For 1998, Eurostat has corrected the unemployment rate from 4.5 to 4.7 percent. In the projected business cycle scenario, the unemployment rate falls from 4.4 percent this year to 4.2 percent in 2000. In spite of such a notable reduction in the jobless rate by ½ percentage point over three years, further efforts will be necessary in order to reach the benchmark figure of 3.5 percent by 2003.

TAX REFORM REQUIRES FIRM CONTROL OVER GOVERNMENT OUTLAYS IN 2000

General government net borrowing will remain at the level of the previous year of just above 2 percent of GDP in 1999. In 2000, it is set to rise to around 2½ percent, as a consequence of the tax reform. Tight control over expenditure will be necessary, if new stringent measures of fiscal consolidation are to be avoided in the medium term.

Despite the additional burden imposed by the first leg of higher family benefits, the general government deficit in 1999 should remain at a ratio of 2.1 percent of GDP, unchanged from the previous year, staying in line with the stability programme.

Since the growth forecast for 1999 has not been altered, also the base for the projection of public revenues remains essentially the same. Somewhat more cautious assumptions for wage increases are offset by better employment prospects. Thus, there is no change from the earlier WIFO forecast in the aggregate "compensation of employees", on which the projection of income tax revenues rests.

Value added tax, next to income tax the second major source of public revenues, is expected to produce markedly higher yields than last year, given the buoyancy of domestic demand.

In 2000, the tax reform will lead to budgetary strain. The targeted 2.5-percent ratio of general government net borrowing to GDP will only be attained if tight control is exerted over public expenditures. A more favourable outturn in a year of massive tax cuts and additional family benefits could be expected only in the event of excellent business conditions. If, as a consequence of the tax reform, another fiscal consolidation "package" becomes necessary, this would counter-act the intended positive impact of the reform on the economy and prove a wrong political move altogether.

Even if the tax reform, by way of its stimulating cyclical effects, will lead to higher government revenues, policy will have to maintain a clearly restrictive stance on expenditures for several years to come, in order to comply with the commitments laid down in the stability programme and fixed by the Ecofin Council, and in order not to fall behind the achievements in fiscal consolidation made by other EU countries. Government net borrowing in the EU area will likely average 1.5 percent of GDP in 1999 and, according to the projections by the European Commission, fall to 1.3 percent in 2000. The next big challenge for Austrian fiscal policy is scheduled for 2001, when a new agreement on fiscal revenue sharing is due to be concluded between the Federal government and the lower-level territorial authorities (the Federal States and the municipalities).

Cut-off date: 30 June 1999.