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 **ÖSTERREICHISCHES INSTITUT FÜR
WIRTSCHAFTSFORSCHUNG**

Sluggish Cyclical Recovery
Economic Outlook for 2010 and 2011

March 2010

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Austrian Institute of Economic Research

Abstract

As from mid-2009, economic activity in Austria stabilised, supported by exports and manufacturing output. Yet, the tentative rebound has not gained momentum, notably because the turnaround has so far not extended to private investment. Real GDP is therefore expected to grow by no more than 1.3 percent in the current year. In 2011, fiscal consolidation is to set in, whose impact on aggregate demand is as yet largely unknown. WIFO expects for 2011 real GDP growth of 1.4 percent, unemployment rising to 7.7 percent of the dependent labour force, an inflation rate of 1.8 percent and a general government deficit of 4 percent of GDP.

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Sluggish Cyclical Recovery

Economic Outlook for 2010 and 2011

As from mid-2009, economic activity in Austria stabilised, supported by exports and manufacturing output. Yet, the tentative rebound has not gained momentum, notably because the turnaround has so far not extended to private investment. Real GDP is therefore expected to grow by no more than 1.3 percent in the current year. In 2011, fiscal consolidation is to set in, whose impact on aggregate demand is as yet largely unknown. WIFO expects for 2011 real GDP growth of 1.4 percent, unemployment rising to 7.7 percent of the dependent labour force, an inflation rate of 1.8 percent and a general government deficit of 4 percent of GDP.

Since the middle of 2009, the world economy is recovering from the deep financial market and economic crisis. The revival of activity is driven by expansionary monetary and fiscal policy and is already quite strong in some areas such as Southeast Asia. Yet, the situation on international financial markets remains fragile. In 2010, world trade is expected to expand by 10 percent in volume, and global GDP by 3.3 percent. With a likely GDP increase of 0.9 percent, the EU economy is trailing behind, since internal demand is still subdued and many countries struggle with the repercussions of the real estate and financial market crisis. Moreover, as from 2011, the envisaged budgetary consolidation may dampen demand.

In Austria, in line with the usual cyclical pattern, goods exports and manufacturing output were the first to react to the international recovery, both heading up in real terms since the third quarter 2009. Merchandise exports are projected to increase by 5 percent in volume this year and by 6 percent in 2011. The positive incentives are coming notably from the world-market oriented German manufacturers, while key trading partners in western and eastern Europe, like Italy or Hungary, are still caught in recession this year, thereby weighing on Austrian exports. On the back of reviving exports, real output (value added) of domestic manufacturing is expected to expand by 4.2 percent each in 2010 and 2011. By the forecast horizon, the level of 2008 would still not be reached. Due to the deep slump in production, Austrian manufac-

turing industry lost 75,000 jobs since the middle of 2008, despite the employment-stabilising effects of widespread recourse to government-subsidised short-time work.

The nascent recovery would translate into a cyclical upswing only if higher export and industrial activity would stimulate corporate investment. However, any signs for this to occur are lacking so far, given the large degree of uncertainty and the still low capacity utilisation. Indeed, investment in machinery and equipment as well as construction is likely to recede again this year (by 3.0 percent and 1.0 percent, respectively), before tentatively heading up in 2011 (+4.0 percent and +0.3 percent, respectively).

Private consumption helped sustain economic activity during the recession. Supported by strong real wage gains, higher social transfers and tax cuts, it followed a slow, but steady upward trend. In 2010 and 2011, net real income per capita will edge down somewhat, on account of lower wage settlements and some rebound in inflation (2010: 1.4 percent, 2011: 1.8 percent). Private household demand should nevertheless increase by an inflation-adjusted 0.7 percent per year, benefiting from a slight decline in the saving ratio.

While the stabilisation of business activity in the last few months led to a cautious turnaround of employment and a slower increase in unemployment, the recovery remains too muted overall as to bring joblessness on a downward trend. The financial market and economic crisis causes the number of people out of work (registered unemployed plus those enrolled in training programmes) to ratchet up to 360,000 by 2011, an increase by almost 100,000 from 2008. The unemployment rate will reach 7.7 percent of the dependent labour force (conventional national definition) or 5.4 percent of the total labour force (Eurostat definition).

Like in other countries, a substantial widening of the government deficit dampened the recession in Austria and kept job losses in check. The general government balance is set to weaken to -4¾ percent of GDP in 2010. The Federal government intends to start fiscal consolidation next year: the deficit is to be reduced to 4 percent of GDP through expenditure cuts and tax increases of about equal size, totalling € 3.4 billion. To what extent these measures will dampen consumer and investment demand or be cushioned by a decline in the private household saving ratio can only be judged once concrete measures have been defined. Decisive in this regard will

be their impact on the personal income distribution and on consumer and business confidence.

Methodological Notes and Short Glossary

Period comparisons

Time-series comparisons with the previous period, e.g., the previous quarter, are adjusted for seasonal effects. They also include effects that result from a different number of working days in the period (e.g., Easter). In the text, this is referred to as "seasonally and working day adjusted changes".

The phrase "changed compared with a year before . . .", on the other hand, describes a change compared with the same period a year before and refers to unadjusted time series.

The analysis of the seasonally and working day adjusted development provides more precise information about the actual course of economic activity and shows turning points sooner. However, the data are subject to additional revisions as seasonal adjustment is based on statistical methods.

Real and nominal values

In principle, the values shown must be understood as real values, i.e., adjusted for price effects. Whenever values are shown as nominal values (e.g., foreign trade statistics), this is specifically mentioned.

Inflation, CPI und HICP

The inflation rate measures changes in consumer prices compared with a year before. The Consumer Price Index (CPI) is a measure of national inflation. The Harmonised Index of Consumer Prices (HICP) is the basis for comparable measurement of inflation in the EU and for the evaluation of price stability in the euro area (see <http://www.statistik.at/>).

WIFO Business Cycle Survey and WIFO Investment Survey

The WIFO business cycle survey is a monthly survey in which around 1,100 Austrian firms are asked to assess their current and future economic situation. The WIFO investment survey is conducted twice a year, asking companies about their investment activity (<http://www.itkt.at/>). The indicators are balances between the positive and negative responses expressed as a percentage of the total number of firms sampled.

Unemployment rate

Austrian national definition: The number of persons registered as job seekers with the Public Employment Service expressed as a percentage of the dependent labour force. Labour force is the sum of the unemployed and the persons in dependent employment (measured in standard employment relationships). Database: registrations with the Public Employment Service (AMS) and Association of Austrian social insurance agencies.

Definition according to ILO and EUROSTAT: Any person who is not gainfully employed and is actively seeking work is considered unemployed. Gainfully employed persons comprise all persons who during the reference week worked for at least one hour in a self-employed capacity or in paid employment. Persons receiving child-care benefit and apprentices are classified as gainfully employed, whereas persons in military service or persons carrying out alternative service are not. The unemployment rate is the number of unemployed persons expressed as a percentage of the total labour force (unemployed persons plus gainfully employed persons). Database: data from household surveys ("Mikrozensus").

Terms used in connection with the national definition of the unemployment rate

Persons in training: Persons who at a set date are enrolled in AMS (Public Employment Service) training programmes. When calculating the unemployment rate, their number is not taken into account either in the denominator or in the numerator.

Persons in dependent active employment: "Persons in dependent employment" include persons receiving child-care benefit, as well as persons in military service or persons carrying out alternative service with a valid employment contract. By deducting their number one arrives at the number of "persons in dependent active employment".

The cyclical recovery in Austria and in the EU at large is still fragile and subject to a number of risks relating in particular to the external environment. A crucial factor will be whether a strong rebound of corporate investment sets in before potential demand-dampening effects of the synchronised fiscal consolidation planned in all EU countries materialise.

Vienna, 26 March 2010.

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WIFO
Projections - March 2010

Main results

Percentage changes from previous year

		2006	2007	2008	2009	2010	2011
GDP							
Volume		+ 3.5	+ 3.5	+ 2.0	- 3.6	+ 1.3	+ 1.4
Value		+ 5.2	+ 5.7	+ 4.1	- 1.8	+ 2.0	+ 2.7
Manufacturing¹, volume		+ 9.0	+ 7.3	+ 3.9	- 11.5	+ 4.2	+ 4.2
Wholesale and retail trade, volume		+ 0.8	+ 0.7	+ 0.6	- 3.1	+ 1.0	+ 0.7
Private consumption expenditure, volume		+ 1.8	+ 0.8	+ 0.8	+ 0.4	+ 0.7	+ 0.7
Gross fixed investment, volume		+ 2.4	+ 3.8	+ 1.0	- 7.8	- 1.9	+ 1.9
Machinery and equipment ²		+ 2.0	+ 4.7	+ 0.1	- 9.7	- 3.0	+ 4.0
Construction		+ 2.8	+ 2.9	+ 1.8	- 6.1	- 1.0	+ 0.3
Exports of goods³							
Volume		+ 6.4	+ 9.0	+ 0.3	- 17.7	+ 5.0	+ 6.2
Value		+ 9.5	+ 10.5	+ 2.5	- 19.9	+ 6.1	+ 6.7
Imports of goods³							
Volume		+ 4.1	+ 7.6	+ 0.2	- 15.2	+ 2.4	+ 4.8
Value		+ 8.0	+ 9.6	+ 4.7	- 18.2	+ 5.0	+ 5.3
Current balance	€ bn	+ 7.26	+ 9.62	+ 9.04	+ 6.43	+ 6.98	+ 8.53
	as a percentage of GDP	+ 2.8	+ 3.6	+ 3.2	+ 2.3	+ 2.5	+ 2.9
Long-term interest rate⁴	percent	3.8	4.3	4.3	3.7	3.3	3.5
Consumer prices		+ 1.5	+ 2.2	+ 3.2	+ 0.5	+ 1.4	+ 1.8
Unemployment rate							
Eurostat definition ⁵	percent	4.8	4.4	3.8	5.0	5.2	5.4
National definition ⁶	percent	6.8	6.2	5.8	7.2	7.4	7.7
Persons in active dependent employment⁷		+ 1.7	+ 2.1	+ 2.4	- 1.4	- 0.2	+ 0.1
General government financial balance							
according to Maastricht definition							
as a percentage of GDP		- 1.6	- 0.6	- 0.4	- 3.5	- 4.7	- 4.0

¹ Value added, including mining and quarrying. ² Including other products. ³ According to Statistics Austria.

⁴ 10-year central government bonds (benchmark). ⁵ According to Eurostat Labour Force Survey. ⁶ Public Employment Service Austria, percent of total labour force excluding self employed. ⁷ Excluding parental leave and military service.

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Key policy indicators

	2006	2007	2008	2009	2010	2011
Fiscal policy						
	As a percentage of GDP					
General government financial balance						
according to Maastricht definition	- 1.6	- 0.6	- 0.4	- 3.5	- 4.7	- 4.0
according to National accounts	- 1.7	- 0.7	- 0.5	- 3.6	- 4.8	- 4.0
General government primary balance	+ 1.1	+ 2.2	+ 2.1	- 1.0	- 2.1	- 1.1
 Monetary policy						
	Percent					
3-month interest rate	3.1	4.3	4.6	1.2	0.9	1.1
Long-term interest rate ¹	3.8	4.3	4.3	3.7	3.3	3.5
	Percentage changes from previous year					
Effective exchange rate						
Nominal	+ 0.2	+ 1.1	+ 1.2	+ 0.9	- 0.4	+ 0.1
Real	- 0.5	+ 0.7	+ 0.6	+ 0.4	- 0.8	- 0.1

¹ 10-year central government bonds (benchmark).

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World economy

Percentage changes from previous year

	2006	2007	2008	2009	2010	2011
Real GDP						
World	+ 5.1	+ 5.1	+ 3.1	- 1.0	+ 3.3	+ 3.5
USA	+ 2.7	+ 2.1	+ 0.4	- 2.4	+ 2.5	+ 2.2
Japan	+ 2.1	+ 2.3	- 0.7	- 5.0	+ 1.5	+ 1.5
EU 27	+ 3.2	+ 2.9	+ 0.8	- 4.2	+ 0.9	+ 1.3
Euro area 16	+ 3.0	+ 2.8	+ 0.7	- 4.1	+ 1.0	+ 1.2
New member states ¹	+ 6.5	+ 6.1	+ 3.8	- 3.5	+ 0.4	+ 1.8
China	+ 11.6	+ 13.0	+ 9.7	+ 8.7	+ 9.3	+ 8.6
World trade, volume	+ 9.0	+ 7.1	+ 2.4	- 13.2	+ 10.0	+ 8.0
Market growth²	+ 11.2	+ 7.8	+ 3.6	- 13.5	+ 5.0	+ 5.8
Primary commodity prices						
HWI Index, total	+ 19.7	+ 3.7	+ 22.4	- 29.2	+ 27	+ 4
Excluding energy	+ 22.0	+ 9.5	+ 15.6	- 22.7	+ 15	+ 7
Crude oil prices						
Brent, USD per barrel	65.1	72.5	97.0	61.5	80	82
Exchange rate						
USD per euro	1.256	1.371	1.471	1.393	1.35	1.35

¹ Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania.

² Real import growth of trading partners weighted by Austrian export shares.

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Private consumption, income and prices

	2006	2007	2008	2009	2010	2011
	Percentage changes from previous year, volume					
Private consumption expenditure	+ 1.8	+ 0.8	+ 0.8	+ 0.4	+ 0.7	+ 0.7
Durables	+ 5.6	+ 3.6	+ 2.2	+ 10.9	+ 0.3	+ 0.1
Non-durables and services	+ 1.4	+ 0.5	+ 0.6	- 0.7	+ 0.7	+ 0.8
Household disposable income	+ 3.0	+ 1.7	+ 1.7	+ 0.4	+ 0.6	+ 0.1
Household saving ratio						
As a percentage of disposable income	10.8	11.3	12.0	12.3	12.1	11.6
	Percentage changes from previous year					
Direct lending to domestic non-banks¹	+ 4.5	+ 3.6	+ 7.4	- 1.3	+ 0.9	+ 4.0
Inflation rate						
National	1.5	2.2	3.2	0.5	1.4	1.8
Harmonised	1.7	2.2	3.2	0.4	1.4	1.8
Core inflation ²	1.3	1.9	2.4	1.5	1.2	1.4

¹ End of period.

² Excluding unprocessed food (meat, fish, fruits, vegetables) and energy items.

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Productivity

Percentage changes from previous year

	2006	2007	2008	2009	2010	2011
Total economy						
Real GDP	+ 3.5	+ 3.5	+ 2.0	- 3.6	+ 1.3	+ 1.4
Employment ¹	+ 1.5	+ 1.7	+ 2.3	- 1.1	+ 0.1	+ 0.4
Productivity (GDP per employment)	+ 2.0	+ 1.8	- 0.2	- 2.6	+ 1.2	+ 1.0
Manufacturing						
Production ²	+ 9.2	+ 7.5	+ 3.9	- 11.7	+ 4.2	+ 4.2
Employees ³	+ 0.2	+ 2.6	+ 1.7	- 6.0	- 2.0	- 0.4
Productivity per hour	+ 8.8	+ 5.1	+ 2.7	- 2.3	+ 5.8	+ 4.4
Working hours per day per employee ⁴	+ 0.2	- 0.3	- 0.5	- 3.8	+ 0.5	+ 0.2

¹ Dependent and self-employed according to National Accounts definition.

² Value added, volume.

³ According to Federation of Austrian Social Security Institutions.

⁴ According to 'Konjunkturerhebung' of Statistics Austria.

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Earnings and international competitiveness

Percentage changes from previous year

	2006	2007	2008	2009	2010	2011
Gross earnings per employee ¹	+ 3.2	+ 3.1	+ 2.7	+ 2.3	+ 1.2	+ 1.8
Gross real earnings per employee ¹	+ 1.0	+ 0.5	+ 0.0	+ 1.1	- 0.2	± 0.0
Net real earnings per employee ¹	+ 0.8	+ 0.4	- 0.5	+ 2.3	- 0.4	- 0.2
<i>Total economy</i>						
Unit labour costs	+ 1.0	+ 1.1	+ 2.8	+ 5.1	+ 0.0	+ 0.8
<i>Manufacturing</i>						
Unit labour costs	- 4.2	- 1.7	+ 1.0	+ 9.7	- 3.6	- 2.0
Effective exchange rate - manufactures						
Nominal	+ 0.2	+ 1.2	+ 1.1	+ 0.7	- 0.4	+ 0.1
Real	- 0.4	+ 0.8	+ 0.6	+ 0.4	- 0.8	- 0.1

¹ Employees according to National Accounts definition.

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Labour market

Changes from previous year (1,000^s)

		2006	2007	2008	2009	2010	2011
Demand for labour							
Persons in active employment ¹		+ 55.8	+ 68.1	+ 83.1	- 36.7	- 0.4	+ 7.6
Employees ²		+ 51.5	+ 65.5	+ 76.7	- 44.8	- 5.1	+ 4.8
<i>Percentage changes from previous year</i>		+ 1.7	+ 2.1	+ 2.4	- 1.4	- 0.2	+ 0.1
Nationals		+ 35.0	+ 43.6	+ 53.2	- 39.2	- 4.0	+ 2.2
Foreign workers		+ 16.5	+ 21.9	+ 23.5	- 5.6	- 1.1	+ 2.6
Self-employed ³		+ 4.3	+ 2.6	+ 6.4	+ 8.1	+ 4.7	+ 2.8
Labour supply							
Population of working age	(15 to 64 years)	+ 12.8	+ 15.5	+ 27.7	+ 22.1	+ 26.4	+ 30.7
	(15 to 59 years)	+ 47.3	+ 17.1	+ 17.6	+ 15.9	+ 12.3	+ 15.9
Labour force ⁴		+ 42.3	+ 51.2	+ 73.1	+ 11.3	+ 8.8	+ 19.7
Surplus of labour							
Registered unemployed ⁵		- 13.5	- 16.9	- 10.0	+ 48.1	+ 9.2	+ 12.1
	1,000 ^s	239.2	222.2	212.3	260.3	269.5	281.6
Unemployed persons in training	1,000 ^s	57.5	52.7	50.5	64.1	80.9	78.5
Unemployment rate							
Eurostat definition ⁶	percent	4.8	4.4	3.8	5.0	5.2	5.4
Percent of total labour force ⁵	percent	6.1	5.6	5.2	6.4	6.6	6.9
National definition ^{5,7}	percent	6.8	6.2	5.8	7.2	7.4	7.7
Employment rate							
Persons in active employment ^{1,8}	percent	63.9	64.9	66.1	65.2	64.9	64.6
Total employment (Eurostat) ^{6,8}	percent	70.2	71.4	72.1	71.6	70.9	70.7

¹ Excluding parental leave and military service. ² According to Federation of Austrian Social Security Institutions.

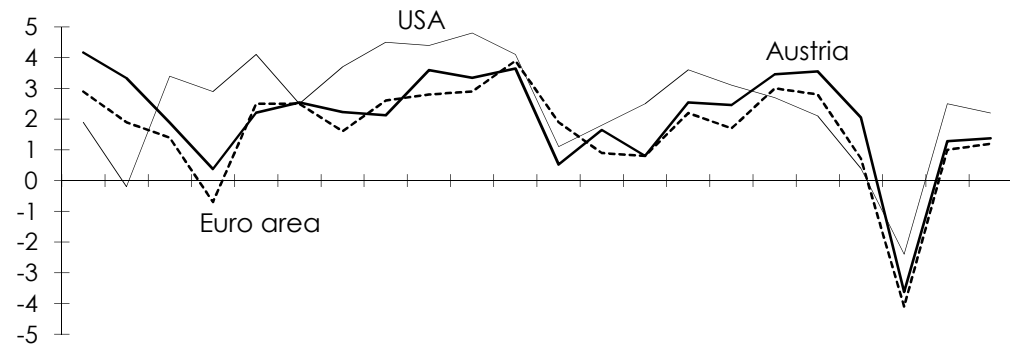
³ According to WIFO. ⁴ Economically active employment plus unemployment.

⁵ According to Public Employment Service Austria ⁶ According to Eurostat Labour Force Survey.

⁷ Percent of total labour force excl. self-employed. ⁸ Percent of population of working age (15 to 64 years).

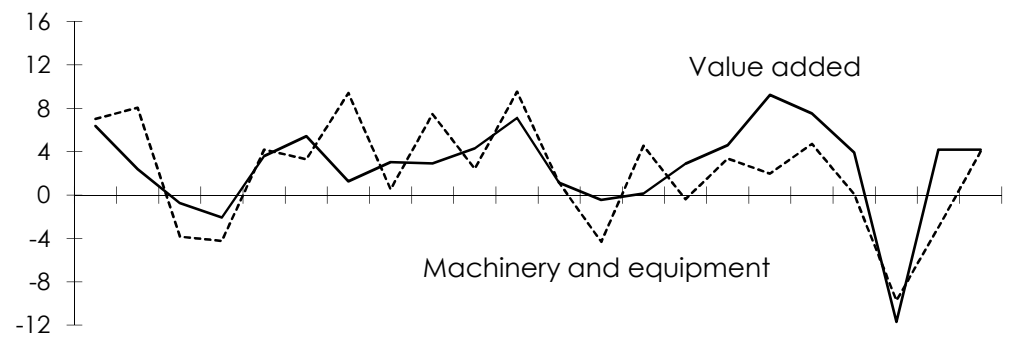
Growth of real GDP

Percent



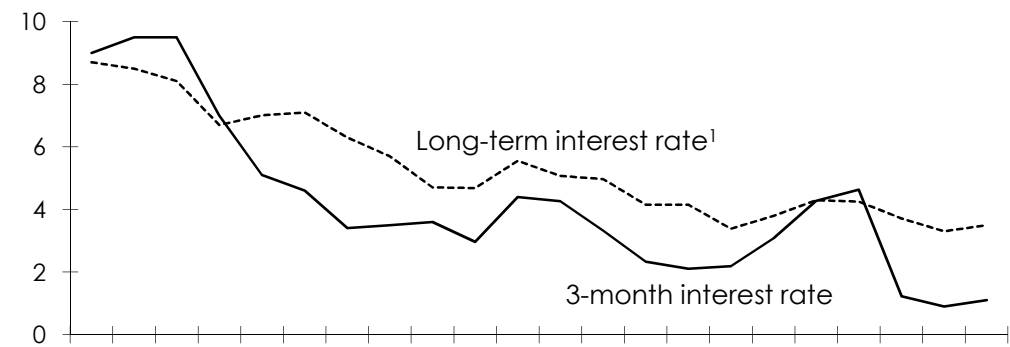
Manufacturing and investment

Percentage changes from previous year, volume



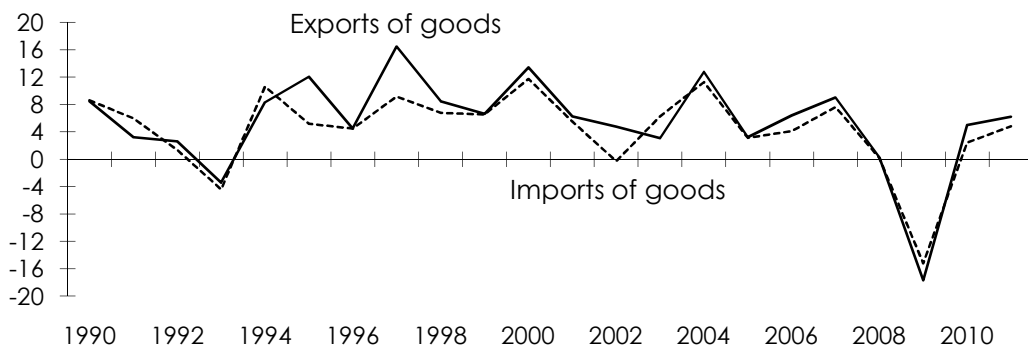
Short-term and long-term interest rates

Percent



Trade

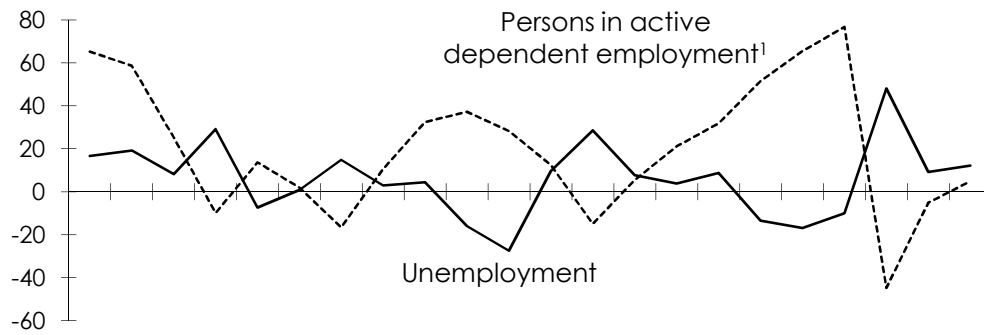
Percentage changes from previous year, volume



¹ 10-year central government bonds (benchmark).

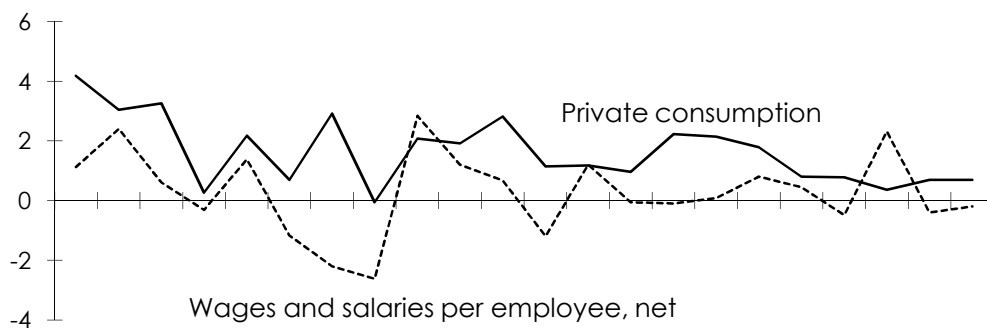
Employment and unemployment

1,000^s from previous year



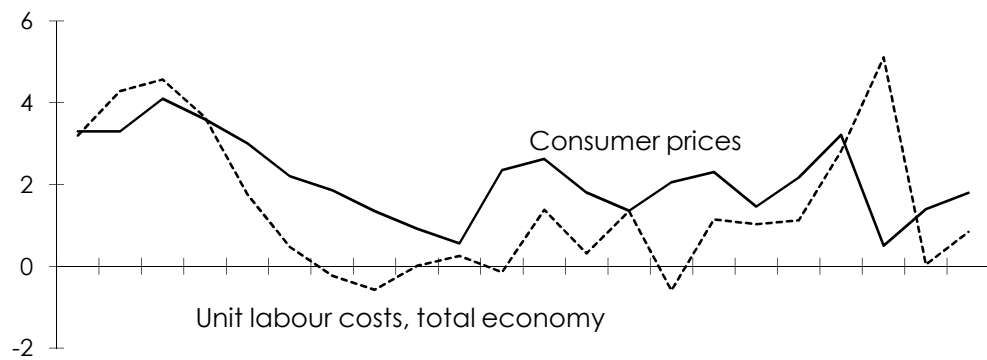
Consumption and income

Percentage changes from previous year, volume



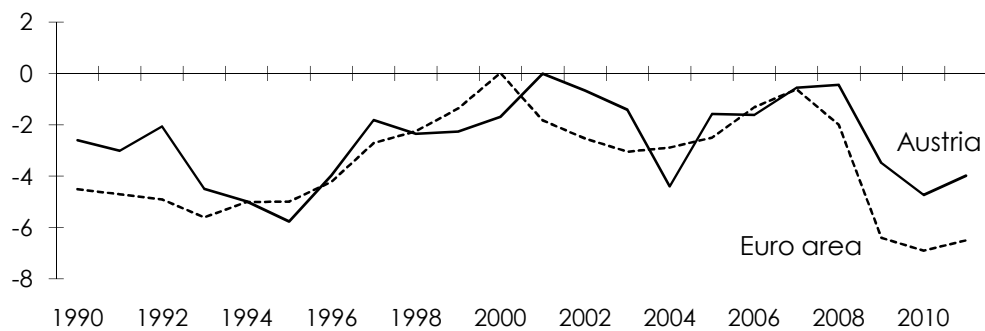
Inflation and unit labour costs

Percentage changes from previous year



General government financial balance

As a percentage of GDP



¹ Excluding parental leave, military service, and unemployed persons in training.