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# Weakness of Aggregate Demand to be Gradually Overcome

## Economic Outlook for 2003 and 2004

**The Austrian economy will only grow by about 0.7 percent in 2003. While retail sales and investment are proving relatively robust, exports and manufacturing output have not strengthened so far. Opinion surveys among firms and households across Europe indicate a tentative brightening of expectations. If the improvement in sentiment is confirmed by a recovery of production, GDP in Austria may expand by 1.4 percent in volume in 2004.**

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In the first half of 2003, demand and output in Austria edged up by only 0.6 percent from the year-earlier period. Unlike in 2001 and 2002, domestic demand is now supporting activity, owing to a moderate but steady rise in consumption and limited gains in construction and equipment investment. Exports, however, have clearly lost momentum. For the third consecutive year, GDP growth in 2003 will fall below the long-term average.

Prospects for 2004 remain highly uncertain. In the euro area, clear signs of a business cycle upturn are still missing, with GDP stagnating on a seasonally-adjusted quarterly basis since the end of 2002 (up by 0.5 percent from last year in the first half of 2003). Hopes for a world-wide recovery have nevertheless gained ground over the last few months. Asia has become the growth pole of the global economy, and lively activity has lately spilled over even to the ailing Japanese economy. In the USA, GDP grew by 2¼ percent in the first semester, if mainly on the back of a substantial increase in military spending.

A rebound in world trade could give incentives to the euro area economy. During summer, business sentiment has improved slightly, and even in Germany developments are now seen with somewhat greater confidence. Still, a number of forces are holding back a speedy recovery: the continued high level of the dollar/euro exchange rate is weighing on exports and investment. Spending on new machinery and motor vehicles, a key element in the business cycle, remains sluggish due to the low degree of capacity utilisation. Stimulus from economic policy in the EU is lacking. As long as internal demand fails to pick up significantly, business activity will but hesitantly recover from the three-year-long stagnation. A vigorous upswing is not in sight. GDP growth in 2004 is projected at around 1½ percent for the euro area, and at 1 percent for Germany.

Demand for Austrian export goods is subdued, reflecting weak internal demand in the EU and in the accession countries, coupled with slight losses of foreign market shares. The rise in the real-effective exchange rate (+2 percent in 2003) cannot be offset in the short run by the sizeable productivity gains in manufacturing brought about by widespread cuts in personnel. Relative unit labour costs vis-à-vis trading partners are edging up, although over a longer period they have fallen markedly (1995 to 2002 –15 percent). Growth of merchandise exports is slowing down significantly, to a projected average real rate of 2 percent in 2003. Next year, a gradual

pick-up of demand in the main trading partner countries should accelerate export growth to 3¾ percent. Tourism, also suffering from sluggish business activity in Europe, may expect no increase in real foreign earnings in the current year.

Conditions for an endogenous upturn of investment remain unfavourable for the time being. Capacity utilisation is clearly below its long-term average, and firms' sales expectations are not yet firmly heading up. Spending on business machinery and equipment should nevertheless gain 2 percent or more this year: the government premium granted to firms boosting investment beyond the level of the last years, while probably not leading to a sustained higher level of spending, may induce firms to carry forward projects envisaged for implementation in 2004.

<i>Main results</i>		1999	2000	2001	2002	2003	2004
		Percentage changes from previous year					
GDP							
Volume		+ 2.7	+ 3.5	+ 0.7	+ 1.1	+ 0.7	+ 1.4
Value		+ 3.4	+ 5.0	+ 2.3	+ 2.3	+ 2.6	+ 2.7
Manufacturing <sup>1</sup> , volume		+ 3.0	+ 6.5	+ 1.3	+ 1.0	± 0.0	+ 2.0
Private consumption expenditure, volume		+ 2.3	+ 3.3	+ 1.5	+ 0.9	+ 1.3	+ 1.6
Gross fixed investment, volume		+ 2.1	+ 5.9	- 2.2	- 4.6	+ 1.7	+ 1.8
Machinery and equipment <sup>2</sup>		+ 4.9	+11.8	- 2.9	- 9.3	+ 2.0	+ 2.0
Construction		+ 0.0	+ 1.2	- 1.5	- 0.5	+ 1.4	+ 1.7
Exports of goods <sup>3</sup>							
Volume		+ 7.7	+13.1	+ 7.5	+ 4.2	+ 2.0	+ 3.8
Value		+ 7.0	+15.6	+ 6.5	+ 4.2	+ 2.0	+ 3.3
Imports of goods <sup>3</sup>							
Volume		+ 6.9	+10.9	+ 5.7	- 1.2	+ 2.3	+ 3.8
Value		+ 6.7	+14.7	+ 5.0	- 2.0	+ 2.0	+ 3.3
Current balance	billion €	- 6.33	- 5.36	- 4.11	+ 0.95	- 0.03	- 0.39
As a percentage of GDP	%	- 3.2	- 2.6	- 1.9	+ 0.4	- 0.0	- 0.2
Long-term interest rate <sup>4</sup>	%	4.7	5.6	5.1	5.0	4.1	4.3
Consumer prices		+ 0.6	+ 2.3	+ 2.7	+ 1.8	+ 1.3	+ 1.2
Unemployment rate							
Percent of total labour force <sup>5</sup>	%	4.0	3.7	3.6	4.3	4.3	4.4
Percent of dependent labour force <sup>6</sup>	%	6.7	5.8	6.1	6.9	7.0	7.1
Dependent employment <sup>7</sup>		+ 1.2	+ 1.0	+ 0.4	- 0.5	+ 0.2	+ 0.5
General government financial balance according to Maastricht definition							
As a percentage of GDP	%	- 2.3	- 1.5	+ 0.3	- 0.2	- 1.0	- 1.2

<sup>1</sup> Value added, including mining and quarrying. - <sup>2</sup> Including other products. - <sup>3</sup> According to Statistics Austria. - <sup>4</sup> 10-year central government bonds (benchmark). - <sup>5</sup> According to Eurostat. - <sup>6</sup> According to Labour Market Service. - <sup>7</sup> Excluding parental leave and military service.

Since the beginning of this year, no official data on manufacturing output are available. The regular WIFO business survey suggests a decline for the first semester; production is likely to have remained ½ percent below the year-earlier level. In view of the unfavourable trend of exports, stagnation should at best be expected on annual average. Firms report no further rundown in their inventories, which may be taken as a first hint for an imminent recovery of production. The projection for next year is for an increase in output by 2 percent. Since production is predominantly demand-constrained, the fact that in 2004 there are 3 more working days than in 2003 should not have a significant impact. In this regard, a slightly positive effect in manufacturing may be offset, on the overall economic level, by output losses in the tourism sector.

Construction investment is more buoyant than last year. The enhancement of the financing capacity of the societies in charge of road and railroad infrastructure is reflected in an increase in civil engineering investment by 15 percent. Firms engaged in new-home building are also turning more optimistic, after an extended period of sluggishness. The need for new dwellings has grown, and permits for subsidised residential building are heading up. Owing to the expansion in civil engineering, overall construction output has stopped receding this year and is expected to grow by an inflation-adjusted 1.4 percent on annual average and by 1.7 percent in 2004. The counter-cyclical timing of investment in better infrastructure is sustaining overall activity. However, with a view to the relatively large share of the construction

sector in GDP, policy should take care to scale back public incentives in the next cyclical boom period.

Domestic demand, having dragged down overall economic growth in 2001 and 2002, is expected to provide positive incentives this year. Encouraging signs are coming not only from investment, but also from private consumption: the latter is gaining 1.3 percent in volume which, while remaining below its long-term trend rate of 2¼ percent, is markedly above the overall rate of growth. Employees' net real per-capita earnings will no longer decline, as they did in the last two years, and the gains in disposable income (including public transfers) are becoming somewhat more solid. Helpful in this regard is not only the low rate of inflation of 1¼ percent in both 2003 and 2004, but also the increase in transfer payments, notably child care benefits. The trade sector may expect real output gains of 2 percent in 2003 and 2¼ percent in 2004. Consumers are cutting down on foreign travel expenditure (-3 percent in 2003), but not on car purchases. The saving ratio, as a percentage of disposable income, is set to move up slightly.

No trend reversal is in sight on the labour market. The number of unemployed is moving up to 239,000 this year and 244,000 in 2004, corresponding to jobless rates of 7.1 percent of the dependent (conventional national definition) and 4.4 percent of the total labour force (Eurostat).

The rise in the number of dependent actively employed by 6,000 and 15,000 this year and next is to a large part due to institutional factors: thus, it includes people in partial retirement ("Altersteilzeit") which have lumped and back-loaded their period out of work while still being registered as active with their employer; this raises nominally the total employment figure by 2,500 in 2003 and 5,000 in 2004. Moreover, the number of unemployed undergoing professional training is higher by roughly 8,000 this year than in 2002, part of whom are counted as employed. At the beginning of the year, the long-awaited decision was taken of granting foreigners residing in Austria easier access to the domestic labour market, which facilitates the taking up of a job particularly for women and young people. The number of foreign jobholders is going up by some 15,000 each in 2003 and 2004.

Despite higher revenues from VAT, the overall tax intake remains well below the growth rate of nominal GDP this year, while government expenditure is rising at a faster pace. The general government balance (Maastricht definition) is projected to be in deficit of 1 percent of GDP in 2003 and 1.2 percent in 2004.