

Stefan Ederer

# Consumption Boosting Economic Growth in Austria

## Economic Outlook for 2016 and 2017

### Consumption Boosting Economic Growth in Austria. Economic Outlook for 2016 and 2017

For the first time in four years, domestic consumption is becoming a main driver of economic growth. Next to the tax reform, which raises private household incomes, expenditure in support of refugees will give a boost to aggregate demand in 2016 and 2017. Annual GDP growth, projected at 1.7 percent respectively, is set to accelerate markedly from the last few years.

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

For definitions used see "Methodological Notes and Short Glossary", <http://www.wifo.ac.at/wwadocs/form/WIFO-BusinessCycle-Information-Glossary.pdf> • All staff members of the Austrian Institute of Economic Research contribute to the Business Cycle Report. • Cut-off date: 15 December 2015.

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ISSN 1605-4709 • © Austrian Institute of Economic Research 2016  
Impressum: Herausgeber: Karl Aiginger • Chefredakteur: Michael Böheim ([Michael.Boeheim@wifo.ac.at](mailto: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

Economic growth in Austria remained subdued in 2015, with an estimated increase in GDP of only 0.8 percent, the fourth annual rate below 1 percent in a row. The weak external environment constrained the expansion of foreign trade, and investment picked up gradually only in the course of the year. Private consumption edged up but marginally from the previous year, due to high unemployment and sluggish income growth.

Despite the weak underlying cyclical momentum, the economy will nevertheless enjoy stronger growth in the years to come, as domestic demand will benefit from more lively consumption. Part of the explanation is the growing number of asylum seekers in 2015 and 2016, which implies higher expenditure on care, basic needs and subsistence payments for the newcomers and thus an increase in public and private consumption. The tax reform taking effect at the beginning of 2016 strengthens net disposable income of private households and will also lead to higher consumption, albeit attenuated by the counter-financing measures.

In addition, the external environment should brighten over the next few years. Business activity in the USA remains robust, while the euro area economy may tentatively recover. The fall in commodity prices is about to bottom out which bodes well for business activity in the emerging markets. Austrian exports should therefore pick up and, together with more buoyant investment in machinery and equipment, provide incentives for domestic output growth in 2016 and 2017. Construction activity, on the other hand, appears to remain subdued. In all, real GDP is projected to expand by 1.7 percent in 2016 as well as in 2017.

The number of persons employed keeps growing, with the bulk of new jobs being created in the services branches. Since the long-term trend towards more part-time work is likely to persist in this area, total work hours will not rise in step with output. Moreover, job creation is not keeping pace with growing labour supply, such that

unemployment will ratchet up further. The jobless rate is set to climb to 9.7 percent of the dependent labour force in 2016 and to 10.2 percent in 2017.

The fall in oil prices is dampening inflation in 2015, an effect due to gradually dissipate in 2016. Moreover, the measures to counter-finance the tax reform 2016 will show up in consumer prices. WIFO expects headline inflation to re-accelerate to 1.5 percent in 2016 and 1.7 percent in 2017.

Table 1: Main results

		2012	2013	2014	2015	2016	2017	
		Percentage changes from previous year						
<b>GDP</b>								
Volume		+ 0.8	+ 0.3	+ 0.4	+ 0.8	+ 1.7	+ 1.7	
Value		+ 2.7	+ 1.8	+ 2.0	+ 2.7	+ 3.6	+ 3.4	
Manufacturing <sup>1</sup> , volume		+ 2.2	- 0.4	+ 1.1	+ 1.2	+ 2.6	+ 2.8	
Wholesale and retail trade, volume		- 1.6	- 0.2	- 0.5	+ 1.7	+ 3.2	+ 3.5	
Private consumption expenditure, volume		+ 0.6	+ 0.1	+ 0.0	+ 0.4	+ 1.7	+ 1.7	
<b>Gross fixed investment, volume</b>								
Machinery and equipment <sup>2</sup>		+ 0.7	- 0.1	+ 1.3	+ 2.6	+ 2.8	+ 2.7	
Construction		+ 2.2	- 2.1	- 1.0	- 1.0	+ 0.8	+ 1.3	
Other investment <sup>3</sup>		+ 0.2	+ 4.1	- 0.7	+ 2.3	+ 2.5	+ 2.7	
<b>Exports of goods<sup>4</sup></b>								
Volume		+ 0.5	+ 2.9	+ 2.7	+ 2.5	+ 4.0	+ 4.4	
Value		+ 1.5	+ 1.8	+ 1.8	+ 3.0	+ 4.5	+ 5.1	
<b>Imports of goods<sup>4</sup></b>								
Volume		- 0.9	- 0.1	+ 1.0	+ 3.2	+ 3.5	+ 4.2	
Value		+ 0.7	- 1.0	- 0.7	+ 1.8	+ 3.9	+ 5.1	
<b>Current balance</b>		billion €	+ 4.73	+ 6.30	+ 6.49	+ 10.23	+ 11.72	+ 12.49
As a percentage of GDP			+ 1.5	+ 1.9	+ 2.0	+ 3.0	+ 3.3	+ 3.4
Long-term interest rate <sup>5</sup>	percent	2.4	2.0	1.5	0.8	0.9	1.2	
Consumer prices		+ 2.4	+ 2.0	+ 1.7	+ 0.9	+ 1.5	+ 1.7	
<b>Unemployment rate</b>								
Eurostat definition <sup>6</sup>	percent	4.9	5.4	5.6	5.7	6.1	6.3	
National definition <sup>7</sup>	percent	7.0	7.6	8.4	9.1	9.7	10.2	
Persons in active dependent employment <sup>8</sup>		+ 1.4	+ 0.6	+ 0.7	+ 0.9	+ 1.0	+ 1.0	
<b>General government financial balance according to Maastricht definition</b>								
As a percentage of GDP			- 2.2	- 1.3	- 2.7	- 1.6	- 1.9	- 1.7

Source: WIFO. 2015 to 2017: forecast. – <sup>1</sup> Value added, including mining and quarrying. – <sup>2</sup> Including weapon systems. – <sup>3</sup> Intellectual property products and cultivated biological resources. – <sup>4</sup> According to Statistics Austria. – <sup>5</sup> 10-year central government bonds (benchmark). – <sup>6</sup> According to Eurostat Labour Force Survey. – <sup>7</sup> According to Public Employment Service Austria, as a percentage of total labour force excluding self employed. – <sup>8</sup> Excluding parental leave, military service.

The subsidies for banks in distress are likely to remain a drag on the government balance, though to a lesser extent than in the past years. The wave of immigration will also put new claims on public expenditure, while the tax reform taking effect in early 2016 will lead to shortfalls in wage and income tax revenues. On the other hand, the budget is exonerated by low interest payments, lower-than-expected retirement benefit outlays and a favourable flow of revenue in 2015. The general government deficit (Maastricht definition) for 2015 is estimated at 1.6 percent of GDP, edging up to 1.9 percent of GDP in 2016, before moderating to 1.7 percent in 2017.

## 1. Global economic trends remaining uneven

Developments in the world economy continue to be uneven. Activity in the USA remains robust, with GDP in the third quarter 2015 up by a healthy 0.5 percent from the

previous period. Output growth is primarily sustained by private consumption, on the back of low unemployment and a steady increase in real estate values since 2012. Investment also contributed importantly to GDP growth in 2015. Most recently, though, signs of slackening activity became more frequent. The ISM Purchasing Managers' Index even fell below the threshold of expansion. Consumer confidence also weakened somewhat. Still, for the period from 2015 to 2017, WIFO expects GDP growth to maintain a steady annual pace of 2½ percent.

In view of the uncertain outlook, the US Central Bank has been hesitating with abandoning the zero-interest-rate policy. While the rather low unemployment rate would warrant a turnaround in the monetary stance, the sluggish momentum of inflation suggests otherwise. However, core inflation (excluding energy and unprocessed food) as the main indicator of domestic inflationary pressure, keeps a stable rate slightly below 2 percent. The Fed therefore envisaged a first move towards higher interest rates at the end of the year<sup>1</sup>. The WIFO projection assumes a cautious and gradual increase in US interest rates over the forecast horizon.

Economic growth in China has followed a steady weakening tendency over the last few years. A major explanation is the structural shift from export-led growth towards domestic demand forces. Indeed, price competitiveness of Chinese manufactures has been weakening for some time. Buoyant economic activity has led to high wage increases and the exchange rate is heading up. Against this background, more and more companies relocate production to other countries. Also, major public investment projects and residential building are hitting against a ceiling here and there. GDP in the third quarter 2015 nevertheless maintained a strong gain of 1.8 percent from the earlier period. The heavy price correction on stock markets observed last summer has apparently had little impact on the real economy. Share prices have to some extent recovered in the last few months. However, with the gradual deregulation of the exchange rate as the Renminbi becomes a key global currency, speculative bubbles on financial markets may arise more frequently. WIFO expects the slowdown of Chinese economic growth to continue, from 6.8 percent in 2015 to 6.2 percent in 2016 and 5.8 percent in 2017.

Many emerging market economies continue to suffer from the sharp fall in commodity prices. Oil prices declined further towards the end of the year, but also quotations for agricultural and industrial raw materials have been heading down over the last years. The major explanation is the global economic weakness and notably slackening demand from China, with severe repercussions for the economies relying on commodity exports such as Brazil or Russia which are both caught in recession. Since raw material prices are expected to recover only gradually in the next few years, growth in the emerging markets is likely to remain subdued.

*Activity in the USA remains robust, despite early signs of some slowdown. The Chinese expansion is held back by the transformation of the economy towards domestic-led growth. The emerging markets keep suffering from the slump in commodity prices.*

## 2. Sagging recovery in the euro area

Business activity in the euro area is slow in gaining momentum. Indeed, demand and output increased by only 0.3 percent in the third quarter 2015 from the earlier period, even less than in the months before. Such slowdown was observed in most of the larger euro area economies, except for France where growth picked up from spring. Output gains are primarily driven by consumer demand, whereas gross fixed investment and exports were less buoyant.

Business surveys for the euro area do not indicate a strengthening of activity any time soon. The regular survey conducted by the European Commission showed last November even a slight weakening of business expectations. Consumer confidence, for its part, firmed somewhat, suggesting that activity will be largely sustained by private consumption also in the months to come. Once the global environment brightens, exports may be expected to strengthen, especially since the

*Business activity in the euro area is recovering only hesitantly, hardly gaining momentum over the forecast period.*

<sup>1</sup> The decision of the US Central Bank is to be taken on 16 December 2015, after the cut-off date of the current forecast.

likely hike in US interest rates should keep the dollar-euro exchange rate low. WIFO expects euro area GDP to expand by 1.5 percent, respectively, in 2015 and 2016, edging up to 1.6 percent in 2017.

Table 2: World economy

	2012	2013	2014	2015	2016	2017
	Percentage changes from previous year					
<i>Real GDP</i>						
World	+ 3.4	+ 3.3	+ 3.4	+ 3.0	+ 3.3	+ 3.5
USA	+ 2.2	+ 1.5	+ 2.4	+ 2.5	+ 2.4	+ 2.6
Japan	+ 1.7	+ 1.4	± 0.0	+ 0.6	+ 1.0	+ 1.2
EU 28	- 0.5	+ 0.2	+ 1.4	+ 1.9	+ 1.8	+ 1.8
Euro area 19	- 0.8	- 0.3	+ 0.9	+ 1.5	+ 1.5	+ 1.6
Germany	+ 0.4	+ 0.3	+ 1.6	+ 1.5	+ 1.6	+ 1.6
CEE5 <sup>1</sup>	+ 0.4	+ 0.9	+ 3.0	+ 3.5	+ 3.1	+ 3.2
China	+ 7.7	+ 7.7	+ 7.3	+ 6.8	+ 6.2	+ 5.8
World trade, volume	+ 2.1	+ 2.6	+ 3.3	+ 1.0	+ 2.0	+ 2.5
Market growth <sup>2</sup>	+ 0.6	+ 1.9	+ 3.6	+ 2.5	+ 4.0	+ 4.4
<i>Primary commodity prices<sup>3</sup></i>						
HWI index, total	- 2.8	- 1.9	- 7.0	- 40	- 3	+ 8
Excluding crude oil	- 14.4	- 6.1	- 6.2	- 20	- 3	+ 10
<i>Crude oil prices</i>						
Brent, \$ per barrel	111.6	108.7	99.0	55	53	57
<i>Exchange rate</i>						
\$ per €	1.286	1.328	1.329	1.10	1.05	1.05

Source: WIFO. 2015 to 2017: forecast. – <sup>1</sup> Czech Republic, Hungary, Poland, Slovakia, Slovenia. – <sup>2</sup> Real import growth of goods of trading partners weighted by Austrian export shares. – <sup>3</sup> Dollar.

With the sluggish recovery of output growth, labour markets will improve only tentatively. Euro area unemployment has been heading down, to a rate of 10.7 percent in October 2015, and is expected to continue its downward trend. Yet, the situation is strikingly different across the member countries, with the highest jobless rates recorded in Spain and Greece, and the lowest one in Germany.

Headline inflation in the euro area remains close to zero. A major factor is the fall in oil prices on international markets. Core inflation, as measured by the HICP (excluding energy and unprocessed food) has been edging up since spring 2015, turning around the trend followed during the past three years. Going forward, inflation may thus head up, once the oil price effect wears off.

In view of the low inflation rate, the European Central Bank (ECB) is trying to spur business activity by monetary expansion. Since March 2015, the Bank has been buying government bonds to the tune of 60 billion € per month. In December, it announced the extension of the bond purchasing programme by six months until the end of March 2017. In addition, the interest rate on deposits held by commercial banks with the Central Bank has been lowered once again to currently -0.3 percent, with the aim of encouraging banks to higher lending. It is unlikely, though, that these measures will succeed in taking the real economy back to a firm growth path. Neither are the projects envisaged in the context of the European Fund for Strategic Investment (EFSI) at a stage where they could generate a substantial demand effect in the foreseeable future.

### 3. Demand induced by inflow of refugees raises growth in Austria

In the first nine months of 2015, demand and output rose only moderately in Austria. Foreign trade provided positive incentives, despite the weak global environment, and also investment in machinery and equipment rebounded; however, private consumption virtually stagnated. Overall, quarterly GDP rose by 0.3 percent in the third quarter 2015 (from the previous period), for the second time in a row. The un-

derlying momentum remained weak also in the year-end quarter. For the whole year 2015, growth of GDP is expected at 0.8 percent.

In 2016, activity should firm markedly. Although consumer confidence has fallen recently to a level last held in the crisis of 2008-09 and the international outlook remains fragile, companies have nevertheless turned more upbeat in their short-term business expectations. Moreover, domestic private and public consumption should provide a stronger cyclical impulse.

The number of asylum seekers rose significantly in 2015 and is set to increase further in 2016. Since applicants receive basic subsistence care while their eligibility is being examined and are entitled to needs-tested minimum income once being officially recognised as refugee or beneficiary of subsidiary protection, private and public consumption are likely to rise substantially in 2016 and 2017 (see box). In addition, the external economic environment is set to improve and firms are expected to reinforce investment in machinery and equipment. WIFO therefore expects growth of real GDP to ratchet up to an annual 1.7 percent in 2016 and 2017.

Private consumption has hardly increased during the last few years, largely on account of high unemployment and sluggish income growth. The gain in real purchasing power deriving from low oil prices has been partly offset by price hikes for rents and services, which exceeded the European average. For the whole year 2015, private consumption may have gained only 0.4 percent from the previous year.

*The rising number of refugees generates additional final demand in 2016 and 2017, boosting both private and public consumption. This will underpin the expected cyclical recovery of the Austrian economy.*

#### *Assumptions for the forecast of refugee immigration*

The number of applications for asylum in Austria has increased significantly in 2015. In line with estimates by the Ministry of Foreign Affairs, WIFO anticipates some 95,000 applications for 2015 (2014: 28,000) and between 100,000 and 130,000 applications for 2016<sup>1</sup>.

The implications are the following: first, there is the cost of basic subsistence care of persons whose application for asylum is in process. Such cost, as defined by regulation, includes food and accommodation, pocket money, health care, counselling, clothing, school necessities, language training etc. The total cost of these services for people in regular accommodation amounts to some 11,000 € per person and year, the cost for unattended minors housed in assisted accommodation, shared apartments or hostels around 45,000 € per person. Multiplied by the average number of asylum seekers (full-year equivalents), one arrives at the total cost of basic subsistence care. On the basis of assumptions by the Federal Ministry of Finance, the WIFO forecast includes 46,000 full-year equivalents for 2015 and 61,000 for 2016<sup>2</sup>, reverting to 46,000 in 2017. The cost of basic subsistence care is covered by public authorities and separated between public and private consumption (including private non-profit organisations like relief agencies or church communities).

Once their status is approved, recognised refugees and beneficiary of subsidiary protection are entitled to needs-tested minimum income. As soon as they take up a job that pays sufficient income, this benefit is cancelled. Based on experience concerning origin and age composition and the related assumptions on recognition as refugee or beneficiary of subsidiary protection as well as on the average length of the recognition process, WIFO anticipates an annual increase in labour supply (including persons in vocational training) from the immigration of refugees of 40,000 persons in 2016 and 48,000 persons in 2017. The expenditure on needs-tested minimum income feeds into private consumption.

<sup>1</sup> Federal Ministry for Europe, Integration and Foreign Affairs, 50 Action Points – A Plan for the Integration of Persons entitled to Asylum or Subsidiary Protection in Austria, Vienna, November 2015, [http://www.bmeia.gv.at/fileadmin/user\\_upload/Zentrale\\_Integration/Publikationen/Integrationsplan\\_final.pdf](http://www.bmeia.gv.at/fileadmin/user_upload/Zentrale_Integration/Publikationen/Integrationsplan_final.pdf). – <sup>2</sup> Federal Ministry of Finance, Austrian Draft Budgetary Plan 2016, Vienna, October 2015, [https://www.bmf.gv.at/wirtschaftspolitik/in-oesterreich/DBP\\_Oktober\\_2015\\_14.10.2015\\_final.pdf?555aev](https://www.bmf.gv.at/wirtschaftspolitik/in-oesterreich/DBP_Oktober_2015_14.10.2015_final.pdf?555aev).

In 2016, private consumption will receive support from the tax reform taking effect at the beginning of the year. The modification of the tax scale for wage and assessed income tax implies substantial gains for net earnings. Assuming full implementation of the counter-financing measures, the net impact of the tax reform on private consumption may be in the order of +0.4 percent of GDP<sup>2</sup>. A similarly strong impulse will

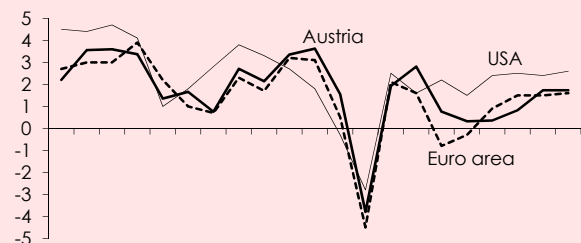
<sup>2</sup> Against this amount have to be set dampening effects on public consumption (Baumgartner, J., Kaniowski, S., "The Tax Reform 2015-16 – Macroeconomic Effects up to 2019", WIFO Bulletin, 2015, 20(22), pp. 250-265, <http://bulletin.wifo.ac.at/58374>).

be provided by the inflow of refugees: a large part of the expenditure on basic subsistence care of asylum seekers and on needs-tested minimum income to which recognised refugees and beneficiaries of subsidiary protection are entitled will directly translate into domestic private consumption. For 2016 and 2017, WIFO projects private consumption to increase by 1.7 percent year-on-year, respectively.

Figure 1: Indicators of economic performance

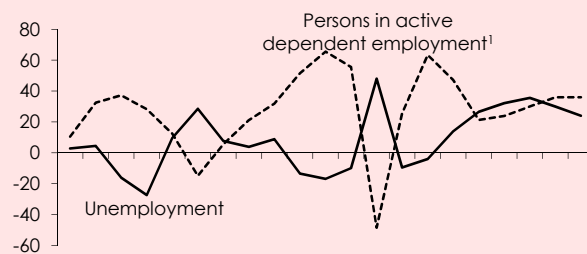
Growth of real GDP

Percent



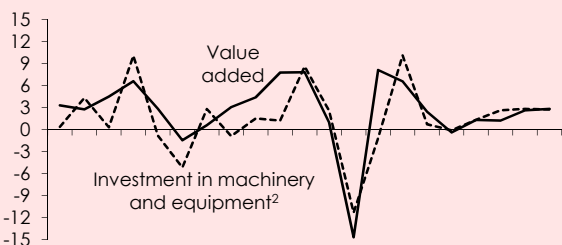
Employment and unemployment

1,000 from previous year



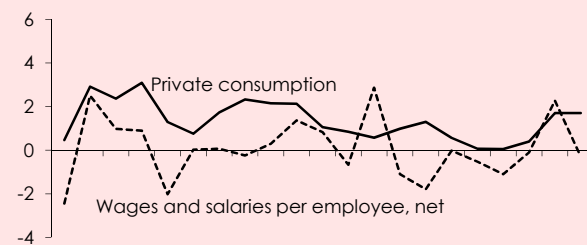
Manufacturing and investment

Percentage changes from previous year, volume



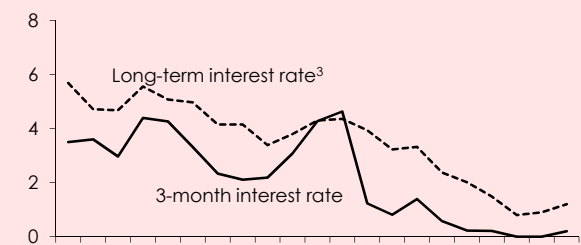
Consumption and income

Percentage changes from previous year, volume



Short-term and long-term interest rates

Percent



Inflation and unit labour costs

Percentage changes from previous year



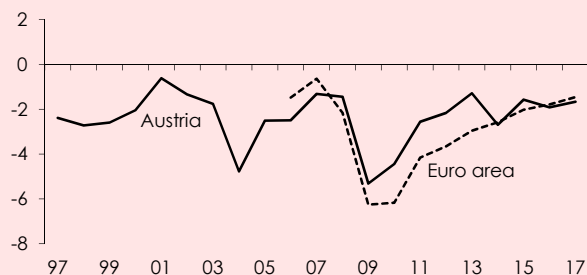
Trade

Percentage changes from previous year, volume



General government financial balance

As a percentage of GDP



Source: WIFO. 2015 to 2017: forecast. – <sup>1</sup> Excluding parental leave, military service, and unemployed persons in training. – <sup>2</sup> 10-year central government bonds (benchmark).

Due to the expenditure on asylum seekers, also public consumption is likely to expand more strongly than assumed in the forecast of last September. WIFO expects an annual increase of 0.7 percent respectively for 2016 and 2017.

Table 3: Private consumption, income and prices

	2012	2013	2014	2015	2016	2017
	Percentage changes from previous year, volume					
Private consumption expenditure	+ 0.6	+ 0.1	+ 0.0	+ 0.4	+ 1.7	+ 1.7
Durables	+ 0.7	- 3.0	- 0.5	- 1.0	+ 2.0	+ 2.5
Non-durables and services	+ 0.5	+ 0.4	+ 0.1	+ 0.5	+ 1.7	+ 1.6
Household disposable income	+ 2.0	- 2.0	+ 0.5	+ 0.4	+ 2.1	+ 1.3
	As a percentage of disposable income					
Household saving ratio						
Including adjustment for the change in net equity of households in pension fund reserves	9.2	7.3	7.8	7.8	8.3	7.9
Excluding adjustment for the change in net equity of households in pension fund reserves	8.5	6.6	7.0	7.0	7.4	7.1
	Percentage changes from previous year					
Direct lending to domestic non-banks <sup>1</sup>	+ 0.0	- 1.2	+ 0.3	+ 2.2	+ 1.3	+ 1.3
	Percentage changes from previous year					
Inflation rate						
National	2.4	2.0	1.7	0.9	1.5	1.7
Harmonised	2.6	2.1	1.5	0.8	1.5	1.7
Core inflation <sup>2</sup>	2.3	2.3	1.9	1.7	1.7	1.6

Source: WIFO. 2015 to 2017: forecast. – <sup>1</sup> End of period. – <sup>2</sup> Excluding unprocessed food (meat, fish, fruits, vegetables) and energy items.

Table 4: Earnings and international competitiveness

	2012	2013	2014	2015	2016	2017
	Percentage changes from previous year					
Gross earnings per employee <sup>1</sup>	+ 2.7	+ 1.9	+ 1.4	+ 1.4	+ 1.3	+ 1.5
Gross real earnings per employee <sup>2</sup>	+ 0.3	- 0.1	- 0.3	+ 0.5	- 0.2	- 0.2
Net real earnings per employee <sup>2</sup>	- 0.0	- 0.5	- 1.1	- 0.1	+ 2.3	- 0.3
Unit labour costs						
Total economy	+ 3.0	+ 2.2	+ 2.2	+ 1.6	+ 0.6	+ 0.9
Manufacturing	+ 2.7	+ 2.5	+ 1.2	+ 0.2	- 0.9	- 0.8
Effective exchange rate, manufactures						
Nominal	- 1.7	+ 1.8	+ 1.2	- 2.8	- 0.1	+ 0.1
Real	- 1.7	+ 2.1	+ 1.5	- 2.9	- 0.3	- 0.3

Source: WIFO. 2015 to 2017: forecast. – <sup>1</sup> Employees according to National Accounts definition. – <sup>2</sup> Deflated by CPI.

#### 4. Sustained growth incentives from foreign trade and investment in machinery and equipment

Investment in machinery and business equipment picked up in the course of 2015. Brightening expectations should induce companies to spend more on the renewal of productive capacities. The regular WIFO Business Cycle Survey of last November also suggests financing conditions turning more favourable. Investment is therefore projected to gather pace in 2016 and 2017, on the back of a pick-up in final demand and better external conditions. Construction investment, however, will post another year-on-year decline in 2015, the third in a row. Since the latest WIFO Business Cycle Survey indicates an increase in business confidence, 2016 and 2017 should see a rebound in construction activity. Details on the implementation of the "residential investment campaign" announced by the federal government have still not been clarified. The major part of the inherent stimulus for the construction indus-

*With the gradual improvement of the international environment, Austria's exports can expect satisfactory gains. Likewise, private investment will provide incentives for stronger GDP growth. Construction activity, however, will expand only slowly.*

try will only take effect in 2017. Overall, gross fixed investment is projected to expand by 1.8 percent in 2016 and by 2.1 percent in 2017.

Austria's foreign trade in 2015 was overshadowed by sluggish activity in the euro area and the emerging markets. Yet, in the third quarter, merchandise export values increased significantly, thanks mainly to buoyant demand from the USA and East Central Europe. Part of the increase was nevertheless due to price increases for deliveries to non-euro-area regions. Exporters apparently make use of the low euro exchange rate to raise their profit margins. For the whole year 2015, WIFO expects exports of goods to expand by 2.5 percent in volume from the previous year, and volume imports by 3.2 percent.

In the next few years, Austria's external environment should be conducive to stronger export gains. In 2016, merchandise exports are projected to grow by 4 percent in volume, followed by +4.4 percent in 2017. With the pick-up in machinery and equipment investment and the revival of private consumption, imports of goods will strengthen as well, by a projected 3.5 percent in volume in 2016 and +4.2 percent in 2017.

Table 5: Productivity

	2012	2013	2014	2015	2016	2017
	Percentage changes from previous year					
<i>Total economy</i>						
Real GDP	+ 0.8	+ 0.3	+ 0.4	+ 0.8	+ 1.7	+ 1.7
Hours worked <sup>1</sup>	- 0.3	- 0.5	+ 0.4	+ 0.7	+ 0.9	+ 0.9
Productivity per hour	+ 1.1	+ 0.8	- 0.1	+ 0.1	+ 0.8	+ 0.8
Employment <sup>2</sup>	+ 1.1	+ 0.6	+ 1.1	+ 0.9	+ 1.1	+ 1.1
<i>Manufacturing</i>						
Production <sup>3</sup>	+ 2.4	- 0.4	+ 1.3	+ 1.2	+ 2.6	+ 2.8
Hours worked <sup>1</sup>	+ 1.1	- 0.7	- 0.0	+ 0.2	+ 0.2	± 0.0
Productivity per hour	+ 1.2	+ 0.3	+ 1.3	+ 1.0	+ 2.4	+ 2.8
Employees <sup>1</sup>	+ 1.5	- 0.3	+ 0.2	- 0.3	± 0.0	± 0.0

Source: WIFO. 2015 to 2017: forecast. – <sup>1</sup> According to National Accounts definition. – <sup>2</sup> Dependent and self-employed according to National Accounts definition. – <sup>3</sup> Value added, volume.

For the tourism sector, 2015 was a highly successful year. Tourism exports rose markedly in the first nine months of the year. Most recently, though, the momentum has largely been lost: restrictions in travelling between Germany and Austria against the background of massive immigration of refugees as well as the terrorist attacks in Paris may have played a role. Over the forecast horizon, WIFO expects further dynamic growth of demand for tourism services, without however reaching the high rate recorded in 2015. Should travellers in the near future shy away from remote destinations out of security concerns, Austria may benefit from the shift in demand from domestic customers as well as from those in the closer neighbourhood.

Rising investment and the upswing on Austria's export markets will benefit the manufacturing sector. After a rather modest performance in 2015, net output will pick up strongly over the forecast period. Even more buoyant will be activity in the trade sector: with consumption growth picking up, value added in wholesale and retail trade will rise by over an annual 3 percent in 2016 and 2017.

## 5. Further increase in unemployment

Despite economic activity being subdued, employment keeps growing in Austria. In November 2015, the number of persons in dependent active employment was about 50,000 or 1.4 percent higher than the year-earlier figure. On annual average 2015, WIFO expects employment growth at 30,000 (+0.9 percent). The cyclical upturn in 2016 and 2017 should accelerate employment growth to 36,000 (+1.0 percent) per year.

Jobs in the area of health and social care posted the strongest gains in 2015. However, part-time jobs are becoming more and more frequent in services and may

*Although total employment is on the rise, the growth in labour supply cannot be fully absorbed. The increase in unemployment is thus expected to continue unabatedly.*



account for a large part of job creation over the forecast period. The total number of hours worked per head will thus continue its downward trend.

The pace of job creation will not suffice for turning the rise in unemployment around, as labour supply growth is unabated; it is driven by a growing population of working age, due inter alia to the immigration of refugees, a rise in the effective retirement age and an increase in the female employment rate<sup>3</sup>.

The rate of unemployment (as defined by the labour market service) is ratcheting up from 8.4 percent in 2014 to 9.1 percent in 2015 and is projected to reach 9.7 percent in 2016 and 10.2 percent in 2017.

Table 6: Labour market

		2012	2013	2014	2015	2016	2017
		Changes from previous year, in 1,000					
<i>Demand for labour</i>							
Persons in active employment <sup>1</sup>		+ 50.1	+ 29.3	+ 31.8	+ 35.0	+ 41.0	+ 41.0
Employees <sup>2</sup>		+ 47.2	+ 21.2	+ 23.8	+ 30.0	+ 36.0	+ 36.0
Percentage changes from previous year		+ 1.4	+ 0.6	+ 0.7	+ 0.9	+ 1.0	+ 1.0
Nationals		+ 9.0	- 8.5	- 8.1	+ 4.0	+ 3.0	+ 3.0
Foreign workers		+ 38.1	+ 29.7	+ 32.0	+ 26.0	+ 33.0	+ 33.0
Self-employed <sup>3</sup>		+ 2.9	+ 8.1	+ 8.0	+ 5.0	+ 5.0	+ 5.0
<i>Labour supply</i>							
Population of working age							
	15 to 64 years	+ 18.0	+ 23.5	+ 33.1	+ 44.4	+ 37.8	+ 34.2
	15 to 59 years	+ 22.3	+ 27.2	+ 33.7	+ 36.4	+ 22.5	+ 15.2
Labour force <sup>4</sup>		+ 64.0	+ 55.9	+ 64.0	+ 70.6	+ 71.0	+ 65.0
<i>Surplus of labour</i>							
Registered unemployed <sup>5</sup>		+ 13.9	+ 26.6	+ 32.2	+ 35.6	+ 30.0	+ 24.0
In 1,000		260.6	287.2	319.4	355.0	385.0	409.0
Unemployed persons in training <sup>5</sup>		in 1,000	66.6	73.5	75.3	65.3	88.3
In percent							
<i>Unemployment rate</i>							
Eurostat definition <sup>6</sup>		4.9	5.4	5.6	5.7	6.1	6.3
As a percentage of total labour force <sup>5</sup>		6.2	6.8	7.4	8.1	8.7	9.1
National definition <sup>5,7</sup>		7.0	7.6	8.4	9.1	9.7	10.2
<i>Employment rate</i>							
Persons in active employment <sup>1,8</sup>		67.2	67.5	67.6	67.7	68.0	68.3
Total employment <sup>6,8</sup>		71.4	71.4	71.1	71.2	71.4	71.5

Source: WIFO. 2015 to 2017: forecast. – <sup>1</sup> Excluding parental leave, military service. – <sup>2</sup> According to Federation of Austrian Social Security Institutions. – <sup>3</sup> According to WIFO. – <sup>4</sup> Persons in active employment plus unemployment. – <sup>5</sup> According to Public Employment Service Austria. – <sup>6</sup> According to Eurostat Labour Force Survey. – <sup>7</sup> As a percentage of total labour force, excluding self-employed. – <sup>8</sup> As a percentage of population of working age (15 to 64 years).

## 6. Dampening effects of lower oil prices fading in 2016

Sluggish global demand and a strong supply have led to a decline in prices of raw materials which holds down the rise in consumer prices. Price cuts for internationally traded oil have significantly dampened mineral fuel prices in Austria in 2015. Without this effect, annual headline inflation would have been  $\frac{3}{4}$  percentage point higher. On the other hand, catering services, housing rents and insurance services exerted upward pressure. Overall, consumer prices were on average 0.9 percent higher in 2015 than in 2014, a rate markedly above the ones recorded for Germany and the euro area.

The forecast infers that oil prices hit bottom at the end of 2015 and will gradually pick up during 2016 and 2017. The implicit dampening effect on the consumer price index will last until mid-2016, but abate gradually. On the other hand, the measures

*In the consumer price index, the effect of higher rents and services prices is largely offset by the fall in commodity prices. Going forward, however, inflation should resume an upward trend.*

<sup>3</sup> Underlying the present forecast is the baseline scenario of the population projections released by Statistics Austria in November 2015, which already incorporates the impact of refugee immigration on population growth.

to counter-finance the tax reform, such as hikes in indirect taxes and anti-fraud measures, will push up the index in 2016<sup>4</sup>. WIFO expects headline inflation at an annual 1.5 percent for 2016 and 1.7 percent for 2017.

## 7. Government budgets under major pressure

The cost of bank support and of HETA (the resolution fund for Hypo-Alpe-Adria Bank) has significantly pushed up public expenditure in the last years. In 2014, the general government deficit (Maastricht definition) was thereby raised by 5.1 billion € or 1.5 percent of GDP. The stock of public debt has ratcheted up since the crisis of 2008-09 by almost 29 billion € or 8.7 percent of GDP on account of support for the financial sector<sup>5</sup>. The financial burden persists in 2015 and 2016, albeit to a markedly lesser extent than in the preceding years. In 2015, subsidies for ailing banks will amount to 2.1 billion €. For 2016 and 2017, the projections assume amounts of 700 million € and 600 million €, respectively.

The tax reform which enters into force at the beginning of 2016 will cause losses in wage and income tax revenue of around 4 billion € or 1.1 percent of GDP in the year of implementation, rising to 5.4 billion € p.a. (1.5 percent of GDP) as from 2017. In order to counter-finance the foregone revenues, a series of measures are envisaged, consisting partly of increases in other taxes and partly of moves to combat tax fraud and evasion of social charges. In addition, the federal and the Länder governments shall generate expenditure savings to the amount of 1.1 billion € by cutting subsidies and administrative cost. The present forecast assumes that, as far as the federal government is concerned, the relevant measures have been incorporated into the draft budget for 2016 and will be implemented in due time.

*Despite the financial support for banks in distress, budgetary developments were altogether favourable in 2015.*

*In the years to come, the immigration of refugees will put upward pressure on public expenditure. The general government deficit should nevertheless be kept below 2 percent of GDP.*

Table 7: Key policy indicators

	2012	2013	2014	2015	2016	2017
	As a percentage of GDP					
<i>Fiscal policy</i>						
General government financial balance						
According to Maastricht definition	- 2.2	- 1.3	- 2.7	- 1.6	- 1.9	- 1.7
General government primary balance	0.6	1.3	- 0.2	0.8	0.3	0.5
	In percent					
<i>Monetary policy</i>						
3-month interest rate	0.6	0.2	0.2	0.0	0.0	0.2
Long-term interest rate <sup>2</sup>	2.4	2.0	1.5	0.8	0.9	1.2
	Percentage changes from previous year					
<i>Effective exchange rate</i>						
Nominal	- 1.5	+ 1.7	+ 1.2	- 2.9	- 0.2	+ 0.1
Real	- 1.6	+ 2.0	+ 1.5	- 2.9	- 0.4	- 0.3

Source: WIFO. 2015 to 2017: forecast. – <sup>1</sup> 10-year central government bonds (benchmark).

A further burden on government budgets arises from the inflow of asylum seekers. Expenditure on their basic care and subsistence payments raises public consumption and government transfers. Additional outlays for need-tested minimum income will be reflected by higher social benefits in cash. Further cost arises from integration measures and the maintenance of law and public security. Total cost is estimated at

<sup>4</sup> According to WIFO calculations, the impact of the tax reform on the inflation rate is +0.3 percentage points in 2016 and +0.2 percentage points in 2017 (Baumgartner, J., Kaniovski, S., "The Tax Reform 2015-16 – Macroeconomic Effects up to 2019", WIFO Bulletin, 2015, 20(22), pp. 250-265, <http://bulletin.wifo.ac.at/58374>).

<sup>5</sup> See Schratzenstaller, M., "Große Herausforderungen für die Budgetpolitik durch Steuerreform, Zukunftsinvestitionsbedarf und Konsolidierungsvorgaben. Bundesfinanzrahmen 2016 bis 2019 und Bundesvoranschlag 2016", WIFO-Monatsberichte 2015, 88(11), pp. 827-844, <http://monatsberichte.wifo.ac.at/58521>).

1.2 billion € for 2015, projected to increase to 2.2 billion € in 2016 and 2.1 billion € in 2017 (see box)<sup>6</sup>.

The additional burden on the budget balance ought to be set against a number of exonerating elements. Thus, revenues from assessed income tax and from capital gains tax are above plan for 2015, and outlays for retirement benefits are lower than anticipated. Persistently low interest rates also dampen the financing cost of public debt. The pick-up in private consumption projected for 2016 and 2017 will boost indirect tax revenues. The general government deficit (Maastricht definition) for 2015 will likely turn out at the equivalent of 1.6 percent of GDP. For 2016, WIFO projects the deficit ratio to move up to 1.9 percent, before moderating to 1.7 percent in 2017. Abstracting from the subsidies to banks in difficulty, the evolution of the general government deficit would be from 1 percent of GDP in 2015 to 1.7 percent in 2016 and 1.6 percent in 2017.

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## 8. Risks to the forecast

The uncertainties surrounding the wave of immigration represent the major risk to the current forecast. The assumption on the number of applications for asylum follows the official government estimates (see box). This number depends on many factors (policy measures, weather etc.) that are difficult to predict. Also the composition of immigration by country of origin and age group, and the assumptions on the share of applicants receiving official status as refugee or beneficiary of subsidiary protection as well as on the average duration of the recognition process are based upon the experience gained in the last few years.

Deviations from the assumptions underlying the projections are possible both ways, with repercussions on private and public consumption and eventually on GDP. Also the general government balance and the labour market situation will depend on the actual number of immigrants.

For the government budgets, risks also emanate from the support for the financial sector. Moreover, it is unclear whether the additional revenues from measures taken to combat tax fraud and evasion of social charges, budgeted at some 1.9 billion €, will actually be realised in full already in 2016.

A further risk relates to uncertain prospects for the world economy. On the one hand, signs of a slowdown in the USA are mounting. On the other, it is unclear how much friction the restructuring of the Chinese economy towards more domestic consumption and a flatter growth trend will cause. It is unlikely that this process will be smooth and without occasional adjustment problems, both in the real economy and in the financial sector.

Equally uncertain is the further course of monetary policy in the USA. The announcement of a raise in interest rates has in the past triggered massive capital outflows from the emerging markets, accompanied by financial market turbulence. While the latter have been absent to date, a belated reaction of market participants also in the present instance cannot be entirely ruled out.

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<sup>6</sup> These estimates do not include additional tax revenues from incremental GDP growth induced by immigration. The figures refer to annual total expenditure rather than to the respective increase from the previous year (excluding outlays for minimum income around 250 million € or 0.08 percent of GDP in 2014).