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 **ÖSTERREICHISCHES INSTITUT FÜR  
WIRTSCHAFTSFORSCHUNG**

**Stimulating Effects of Tax Cuts  
Dampened By Counter-Financing  
Measures**

**Economic Outlook for 2015 and 2016**

**June 2015**

# Stimulating Effects of Tax Cuts Dampened By Counter-Financing Measures

## Economic Outlook for 2015 and 2016

June 2015

Austrian Institute of Economic Research

### Abstract

At a projected rate of 0.5 percent for 2015, GDP growth in Austria remains subdued for the fourth consecutive year. With intra-EU trade picking up in 2016, domestic growth should accelerate to 1.3 percent. Exports will also be sustained by the significant depreciation of the euro. The tax reform 2015-16 will give support to private demand, while restraining public consumption. The moderate pace of growth over the projection period will not bring the rise in unemployment to a halt.

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# Stimulating Effects of Tax Cuts Dampened By Counter-Financing Measures

## Economic Outlook for 2015 and 2016

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*At a projected rate of 0.5 percent for 2015, GDP growth in Austria remains subdued for the fourth consecutive year. With intra-EU trade picking up in 2016, domestic growth should accelerate to 1.3 percent. Exports will also be sustained by the significant depreciation of the euro. The tax reform 2015-16 will give support to private demand, while restraining public consumption. The moderate pace of growth over the projection period will not bring the rise in unemployment to a halt.*

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GDP growth for Austria is projected at 0.5 percent for 2015 and 1.3 percent for 2016, unchanged from the forecast of last March. Sluggish activity is thus extending into its fourth year, to be followed by a gradual recovery in 2016 that is nevertheless unlikely to improve the situation on the labour market, as the unemployment rate (on national definition) will climb to 9.6 percent. The slight acceleration of growth in 2016 is largely owed to a brightening external environment. While the tax cuts will strengthen private domestic demand, the positive stimulus will be dampened by the restraining effects of the counter-financing measures on public consumption, such that the overall growth effects of the tax reform will be negligible until 2016<sup>1</sup>.

Both international and domestic factors are responsible for the continued cyclical sluggishness in 2015. Private household incomes are eroded by a comparatively high rate of inflation, notably for housing rents, a high tax burden by international standards and a critical labour market situation. Although the tax burden will be alleviated by the tax reform in 2016, the stimulating effects will be offset on the one hand by the counter-financing measures. On the other hand, over half of the implicit net

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<sup>1</sup> In the medium run (until 2019) the impact of the tax reform on GDP is projected at +¼ percent (Baumgartner, J., Kaniovski, S., "Steuerreform 2015/16 – Gesamtwirtschaftliche Wirkungen bis 2019", WIFO-Monatsberichte, 2015, 88(5), p. 399-416, <http://monatsberichte.wifo.ac.at/58171>), in the long term at up to +0,4 percent (Streicher, G., "Schätzung der Auswirkungen der Steuerreform 2015/16 auf die Wertschöpfung mit dem Modell FIDELIO", WIFO-Monatsberichte, 2015, 88(5), pp. 417-424, <http://monatsberichte.wifo.ac.at/58172>).

income gains will not add to final demand in the short term but rather boost private savings, since the major beneficiaries are middle- and high-income earners with a below-average propensity to consume. Further effects of the tax reform and higher residential investment (beyond the projects planned by the Federal Real Estate Agency BIG and already included in the WIFO Forecast of last March) will only materialise as from 2017. The recovery in 2016 therefore hinges primarily upon a pick-up in foreign demand and the associated stimulus to domestic investment. Notably a rebound of industrial production in Europe would be crucial for Austrian exporters heavily specialising in investment goods. Manufacturing output in Germany, Austria's number-one foreign market, is still flat, and lacklustre German imports have so far delayed a recovery in trading partner countries. Yet, the marked decline in the euro exchange rate should benefit industrial production. Also, strengthening private consumption in several EU countries will spill over to domestic investment and give impetus to intra-European trade and thus to Austrian exports.

Should industrial production in Germany and Austria not take off as assumed in the present forecast, a cyclical recovery in 2016 would be doubtful. An earlier and stronger revival may set in should the tax cuts turn out to be counter-financed to a lesser extent than anticipated. In that case, however, the general government deficit would edge up rather than abate from 2.1 percent to 1.9 percent of GDP, as outlined in the present projection.

*Cut-off date: 18 June 2015*

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## 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). Unlike the "seasonally and calendar-adjusted" changes of quarterly GDP as communicated to Eurostat and released by Statistics Austria, WIFO in addition adjusts the series for irregular variations. The WIFO series labelled "trend-cycle component" exhibits a smoother path and offers a better interpretation of the cyclical profile.

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.

### Carry-over (in economic growth)

The carry-over identifies the impact of the dynamics of a series (in seasonally adjusted figures) during one year ( $t_0$ ) on the annual percentage change in the following year ( $t_1$ ). It is defined as the annual percentage change in year  $t_1$ , if GDP in  $t_1$  remains constant at the level of the fourth quarter of year  $t_0$  (in seasonally adjusted terms).

### Average rates of change

The time given refers to the initial and the final value of the period of computation: hence the average rate 2005-2010 comprises as the first rate of change that from 2005 to 2006, and as the last that from 2009 to 2010.

### 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.

### Production Sector

This term comprises the NACE-2008 sections B, C and D (Mining and Quarrying, Manufacturing, Energy Supply) and is here used in an international comparison.

### 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/>). Core inflation as a monetary policy indicator is not clearly defined. WIFO follows the common practice of using the inflation rate excluding the product categories unprocessed food and energy for core inflation. Thus just under 87 percent of the goods and services contained in the consumer price index (CPI 2010) are included in the calculation of core inflation.

### WIFO Business Cycle Survey and WIFO Investment Survey

The WIFO Business Cycle Survey is a monthly survey in which around 1,500 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.konjunkturtest.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 with a valid employment contract. By deducting their number one arrives at the number of "persons in dependent active employment".

## Main results

Percentage changes from previous year

	2011	2012	2013	2014	2015	2016
					<b>Forecasts</b>	
<b>GDP</b>						
Volume	+ 3.1	+ 0.9	+ 0.2	+ 0.3	+ 0.5	+ 1.3
Value	+ 4.9	+ 2.8	+ 1.7	+ 2.0	+ 1.9	+ 2.9
<b>Manufacturing</b> <sup>1</sup> , volume	+ 9.0	+ 1.1	+ 0.6	+ 0.1	± 0.0	+ 2.5
<b>Wholesale and retail trade</b> , volume	+ 3.6	- 0.1	- 1.6	- 0.7	+ 0.7	+ 1.7
<b>Private consumption expenditure</b> , volume	+ 0.7	+ 0.6	- 0.1	+ 0.2	+ 0.4	+ 1.3
<b>Gross fixed investment</b> , volume	+ 6.8	+ 0.5	- 1.5	+ 0.4	+ 0.5	+ 1.5
Machinery and equipment <sup>2</sup>	+ 9.8	- 0.6	- 1.5	+ 1.7	+ 0.5	+ 2.5
Construction	+ 2.6	+ 1.2	- 2.2	+ 0.1	+ 0.5	+ 1.0
Other Investment <sup>3</sup>	+ 12.9	+ 0.5	+ 0.3	- 0.9	+ 0.5	+ 1.2
<b>Exports of goods</b> <sup>4</sup>						
Volume	+ 7.1	+ 0.6	+ 2.8	+ 2.1	+ 3.0	+ 4.0
Value	+ 11.3	+ 1.5	+ 1.8	+ 1.7	+ 2.2	+ 4.7
<b>Imports of goods</b> <sup>4</sup>						
Volume	+ 8.3	- 0.9	+ 0.2	+ 0.9	+ 2.5	+ 3.5
Value	+ 15.3	+ 0.7	- 1.0	- 0.8	+ 1.0	+ 4.5
<b>Current balance</b>	€ bn					
	+ 5.06	+ 4.73	+ 3.06	+ 2.56	+ 3.14	+ 3.16
as a percentage of GDP	+ 1.6	+ 1.5	+ 0.9	+ 0.8	+ 0.9	+ 0.9
<b>Long-term interest rate</b> <sup>5</sup>	percent					
	3.3	2.4	2.0	1.5	0.5	0.5
<b>Consumer prices</b>						
	+ 3.3	+ 2.4	+ 2.0	+ 1.7	+ 1.2	+ 1.7
<b>Unemployment rate</b>						
Eurostat definition <sup>6</sup>	percent					
	4.6	4.9	5.4	5.6	5.7	5.8
National definition <sup>7</sup>	percent					
	6.7	7.0	7.6	8.4	9.3	9.6
<b>Persons in active dependent employment</b> <sup>8</sup>						
	+ 1.9	+ 1.4	+ 0.6	+ 0.7	+ 0.6	+ 0.7
<b>General government financial balance</b>						
according to Maastricht definition						
as a percentage of GDP	- 2.6	- 2.2	- 1.3	- 2.4	- 2.1	- 1.9

<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> Public Employment Service Austria, percent of total labour force excluding self employed. <sup>8</sup> Excluding parental leave and military service.

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## World economy

Percentage changes from previous year

	2011	2012	2013	2014	2015	2016
					<b>Forecasts</b>	
<b>Real GDP</b>						
World	+ 4.2	+ 3.4	+ 3.4	+ 3.4	+ 3.1	+ 3.4
USA	+ 1.6	+ 2.3	+ 2.2	+ 2.4	+ 2.4	+ 2.4
Japan	- 0.5	+ 1.7	+ 1.6	- 0.1	+ 1.2	+ 1.4
EU 28	+ 1.7	- 0.5	±0.0	+ 1.3	+ 1.7	+ 1.8
Euro area 19	+ 1.6	- 0.8	- 0.4	+ 0.9	+ 1.3	+ 1.5
Germany	+ 3.6	+ 0.4	+ 0.1	+ 1.6	+ 1.4	+ 1.7
CEE5 <sup>1</sup>	+ 3.3	+ 0.5	+ 1.0	+ 3.0	+ 2.9	+ 3.1
China	+ 9.3	+ 7.8	+ 7.8	+ 7.4	+ 6.5	+ 6.5
<b>World trade, volume</b>	+ 6.0	+ 2.1	+ 2.7	+ 3.3	+ 3.4	+ 4.2
<b>Market growth<sup>2</sup></b>	+ 7.4	+ 0.8	+ 1.9	+ 3.3	+ 3.0	+ 4.0
<b>Primary commodity prices<sup>3</sup></b>						
HWWI Index, total	+ 28.6	- 2.8	- 1.9	- 7.0	- 28	+ 4
Excluding energy	+ 19.2	- 14.4	- 6.1	- 6.2	- 24	- 8
<b>Crude oil prices</b>						
Brent, USD per barrel	111.3	111.6	108.7	99.0	65	70
<b>Exchange rate</b>						
USD per euro	1.392	1.286	1.328	1.329	1.10	1.10

<sup>1</sup> Poland, Slovakia, Slovenia, Czech Republic, Hungary.

<sup>2</sup> Real import growth of trading partners weighted by Austrian export shares.

<sup>3</sup> In USD.

## Key policy indicators

	2011	2012	2013	2014	2015	2016
					<b>Forecasts</b>	
<b>Fiscal policy</b>						
					As a percentage of GDP	
<b>General government financial balance</b> according to Maastricht definition	- 2.6	- 2.2	- 1.3	- 2.4	- 2.1	- 1.9
<b>General government primary balance</b>	0.2	0.5	1.2	- 0.0	0.2	0.4
<b>Monetary policy</b>						
					Percent	
3-month interest rate	1.4	0.6	0.2	0.2	0.1	0.1
Long-term interest rate <sup>1</sup>	3.3	2.4	2.0	1.5	0.5	0.5
					Percentage changes from previous year	
<b>Effective exchange rate</b>						
Nominal	+ 0.2	- 1.5	+ 1.7	+ 1.2	- 3.2	- 0.1
Real	+ 0.6	- 1.6	+ 2.0	+ 1.5	- 3.0	- 0.3

<sup>1</sup> 10-year central government bonds (benchmark).

## Productivity

Percentage changes from previous year

	2011	2012	2013	2014	2015	2016
					<b>F o r e c a s t s</b>	
<b>Total economy</b>						
Real GDP	+ 3.1	+ 0.9	+ 0.2	+ 0.3	+ 0.5	+ 1.3
Hours worked <sup>1</sup>	+ 2.0	- 0.1	- 0.5	+ 0.8	± 0.0	+ 0.1
<b>Productivity per hour</b>	+ 1.1	+ 1.0	+ 0.7	- 0.5	+ 0.5	+ 1.2
Employment <sup>2</sup>	+ 1.7	+ 1.1	+ 0.7	+ 0.9	+ 0.9	+ 0.8
<b>Manufacturing</b>						
Production <sup>3</sup>	+ 8.8	+ 1.2	+ 0.7	+ 0.2	± 0.0	+ 2.5
Hours worked <sup>1</sup>	+ 1.6	+ 1.2	- 0.4	- 0.6	- 0.6	+ 0.2
<b>Productivity per hour</b>	+ 7.0	- 0.1	+ 1.1	+ 0.9	+ 0.6	+ 2.3
Employees <sup>1</sup>	+ 1.9	+ 1.6	- 0.1	+ 0.1	- 0.3	+ 0.1

<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.

## Private consumption, income and prices

	2011	2012	2013	2014	2015	2016
					<b>Forecasts</b>	
	Percentage changes from previous year, volume					
<b>Private consumption expenditure</b>	+ 0.7	+ 0.6	- 0.1	+ 0.2	+ 0.4	+ 1.3
Durables	+ 4.6	- 0.1	- 3.2	+ 0.1	+ 0.5	+ 3.8
Non-durables and services	+ 0.3	+ 0.7	+ 0.2	+ 0.2	+ 0.4	+ 1.0
<b>Household disposable income</b>	- 1.1	+ 1.9	- 2.1	+ 0.4	+ 0.4	+ 2.0
	As a percentage of disposable income					
<b>Household saving ratio</b>						
Including adjustment for the change in net equity of households in pension fund reserves	7.8	9.0	7.3	7.5	7.5	8.1
Excluding adjustment for the change in net equity of households in pension fund reserves	7.1	8.3	6.5	6.7	6.7	7.3
	Percentage changes from previous year					
<b>Direct lending to domestic non-banks<sup>1</sup></b>	+ 2.7	+ 0.0	- 1.2	+ 0.3	+ 1.0	+ 1.2
<b>Inflation rate</b>						
National	3.3	2.4	2.0	1.7	1.2	1.7
Harmonised	3.6	2.6	2.1	1.5	1.1	1.7
Core inflation <sup>2</sup>	2.8	2.3	2.3	1.9	1.8	1.7

<sup>1</sup> End of period.

<sup>2</sup> Excluding unprocessed food (meat, fish, fruits, vegetables) and energy items.

## Earnings and international competitiveness

Percentage changes from previous year

	2011	2012	2013	2014	2015	2016
					<b>Forecasts</b>	
<b>Wages and salaries per employee<sup>1</sup></b>						
<b>Gross earnings</b>	+ 1.8	+ 2.7	+ 1.7	+ 1.8	+ 1.5	+ 1.7
<b>Gross real earnings<sup>2</sup></b>	- 1.4	+ 0.3	- 0.3	+ 0.1	+ 0.3	+ 0.0
<b>Net real earnings<sup>2</sup></b>	- 1.8	- 0.1	- 0.7	- 0.4	- 0.3	+ 2.4
<b>Unit labour costs</b>						
Total economy	+ 0.5	+ 2.9	+ 2.4	+ 2.4	+ 1.9	+ 1.4
Manufacturing	- 3.2	+ 3.7	+ 1.8	+ 1.9	+ 1.5	- 0.4
<b>Effective exchange rate - manufactures</b>						
Nominal	+ 0.1	- 1.7	+ 1.8	+ 1.2	- 3.3	- 0.1
Real	+ 0.5	- 1.7	+ 2.1	+ 1.5	- 3.1	- 0.3

<sup>1</sup> Employees according to National Accounts definition.

<sup>2</sup> Deflated by CPI.

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## Labour market

Changes from previous year (1,000<sup>s</sup>)

		2011	2012	2013	2014	2015	2016
						<b>Forecasts</b>	
<b>Demand for labour</b>							
Persons in active employment <sup>1</sup>		+ 69.9	+ 50.1	+ 29.3	+ 30.2	+ 27.0	+ 29.0
Employees <sup>2</sup>		+ 63.3	+ 47.2	+ 21.2	+ 23.8	+ 22.0	+ 24.0
<i>Percentage changes from previous year</i>		+ 1.9	+ 1.4	+ 0.6	+ 0.7	+ 0.6	+ 0.7
Nationals		+ 25.7	+ 9.0	- 8.5	- 8.1	- 1.0	- 1.0
Foreign workers		+ 37.7	+ 38.1	+ 29.7	+ 32.0	+ 23.0	+ 25.0
Self-employed <sup>3</sup>		+ 6.6	+ 2.9	+ 8.1	+ 6.4	+ 5.0	+ 5.0
<b>Labour supply</b>							
Population of working age	(15 to 64 years)	+ 31.3	+ 18.0	+ 23.5	+ 33.1	+ 25.5	+ 23.3
	(15 to 59 years)	+ 11.7	+ 22.3	+ 27.2	+ 33.7	+ 18.7	+ 8.5
Labour force <sup>4</sup>		+ 65.8	+ 64.0	+ 55.9	+ 62.4	+ 67.0	+ 47.0
<b>Surplus of labour</b>							
Registered unemployed <sup>5</sup>		- 4.1	+ 13.9	+ 26.6	+ 32.2	+ 40.0	+ 18.0
	1,000 <sup>s</sup>	246.7	260.6	287.2	319.4	359.4	377.4
Unemployed persons in training	1,000 <sup>s</sup>	63.2	66.6	73.5	75.3	61.3	58.3
<b>Unemployment rate</b>							
Eurostat definition <sup>6</sup>	percent	4.6	4.9	5.4	5.6	5.7	5.8
Percent of total labour force <sup>5</sup>	percent	6.0	6.2	6.8	7.4	8.2	8.6
National definition <sup>5,7</sup>	percent	6.7	7.0	7.6	8.4	9.3	9.6
<b>Employment rate</b>							
Persons in active employment <sup>1,8</sup>	percent	66.6	67.2	67.5	67.6	67.8	68.0
Total employment (Eurostat) <sup>6,8</sup>	percent	71.1	71.4	71.4	71.1	71.2	71.3

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

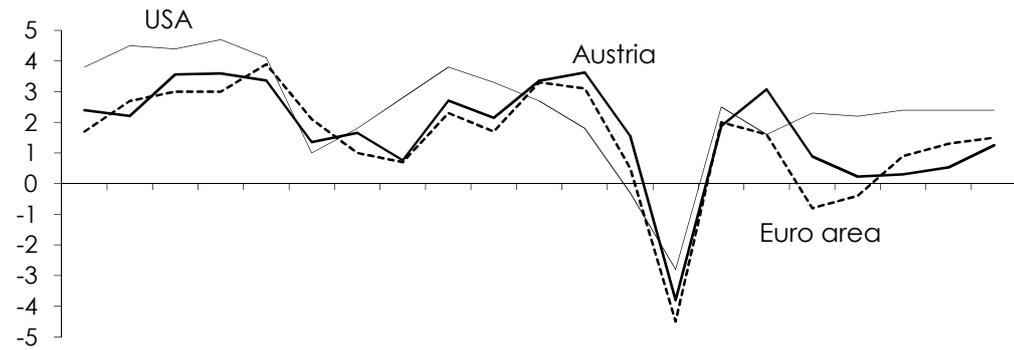
<sup>3</sup> According to WIFO. <sup>4</sup> Persons in active employment plus unemployment.

<sup>5</sup> According to Public Employment Service Austria <sup>6</sup> According to Eurostat Labour Force Survey.

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

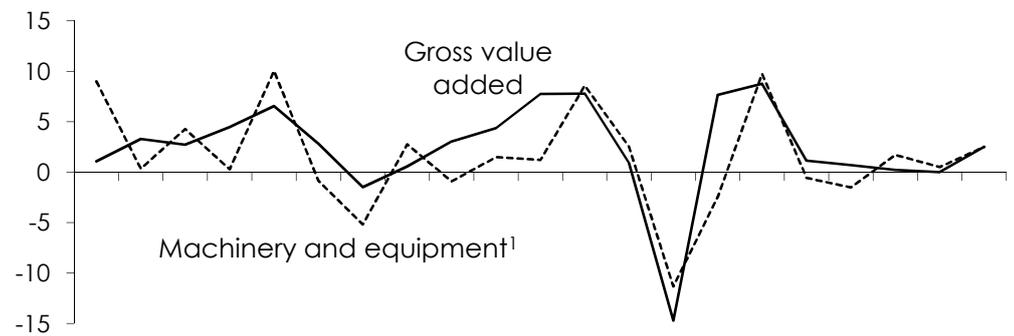
## Growth of real GDP

Percent



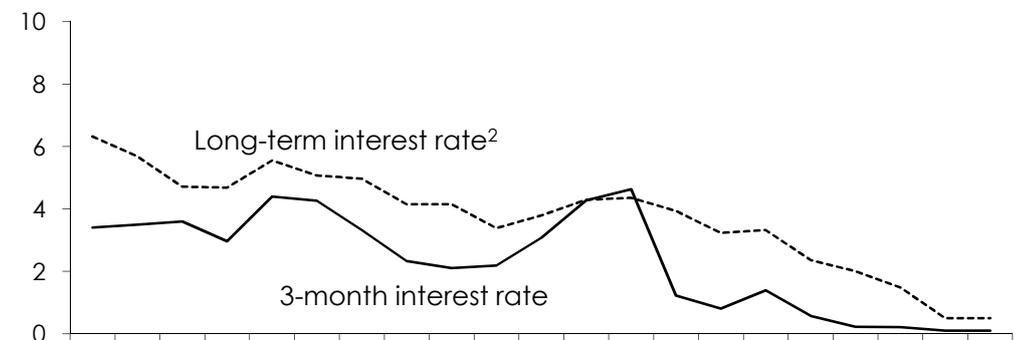
## Manufacturing and investment

Percentage changes from previous year, volume



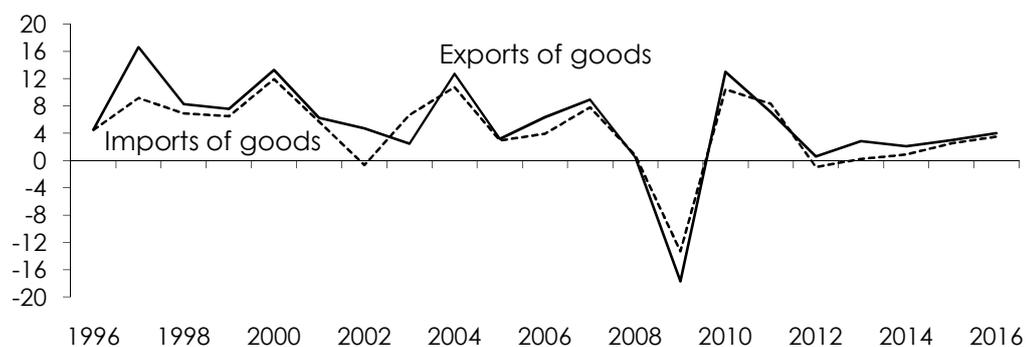
## Short-term and long-term interest rates

Percent



## Trade

Percentage changes from previous year, volume

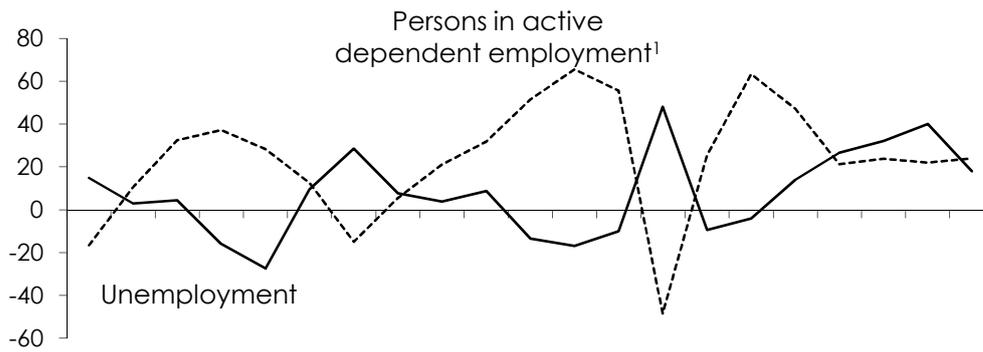


<sup>1</sup> Including weapon systems.

<sup>2</sup> 10-year central government bonds (benchmark).

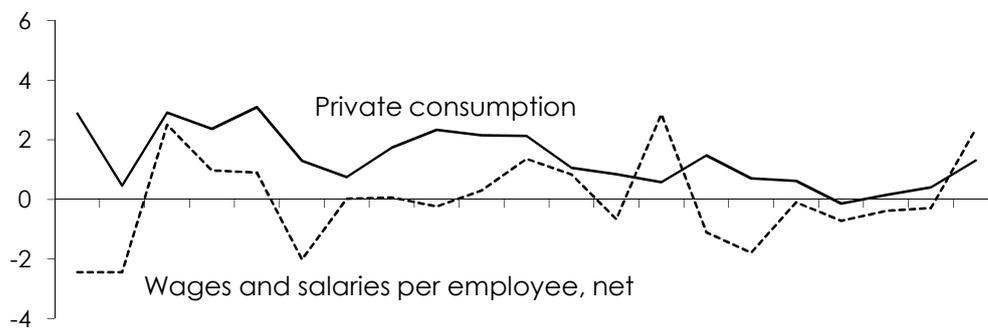
## Employment and unemployment

1,000<sup>s</sup> from previous year



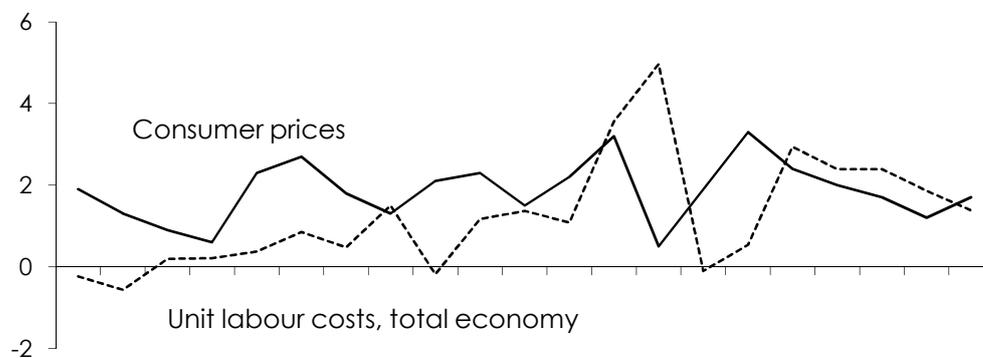
## Consumption and income

Percentage changes from previous year, volume



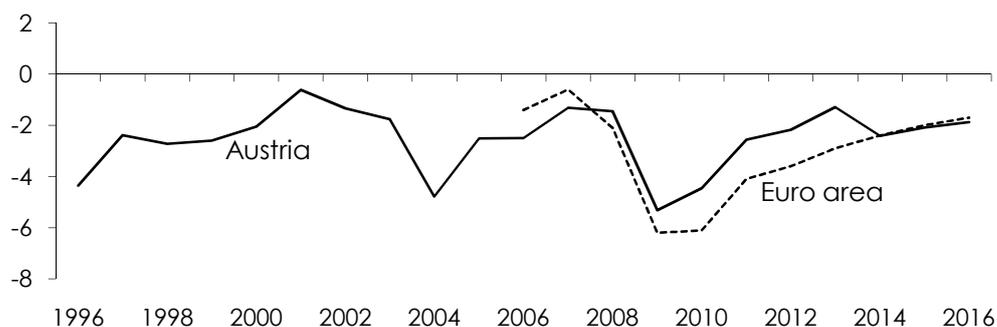
## Inflation and unit labour costs

Percentage changes from previous year



## General government financial balance

As a percentage of GDP



<sup>1</sup> Excluding parental leave, military service, and unemployed persons in training.