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## Update of the Medium-term Forecast for the Austrian Economy 2017 to 2021

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Following the rather sluggish economic growth during the last years, demand and output growth in Austria is expected to accelerate in 2017. In the current year, GDP growth should attain 2 percent followed by an annual average 1.7 percent till 2021, which is broadly in line with the euro area average. Stronger activity will allow employment to expand by 1.6 percent in 2017 and by an average 1.3 percent p.a. over the forecast horizon. With labour supply growth temporarily abating, the unemployment rate should stabilise at 8.9 percent of the dependent labour force (national definition). After 2019, the jobless rate is likely to head up again, reaching 9.1 percent by 2021. Consumer price inflation should remain subdued over the entire period, at an annual rate of 1.8 percent, thereby significantly narrowing the inflation differential vis-à-vis the euro area. In view of the projected cyclical fluctuations and the underlying policy assumptions, general government finances are projected to balance, both in nominal (Maastricht) and structural terms by the end of the forecast period. General government debt, as percent of nominal GDP, is projected to head down as from 2016, by a total 12 percentage points to below 72 percent by 2021.

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This article summarises the results of the March 2017 update of the WIFO Medium-term Forecast 2017-2021 for the Austrian economy of October 2016 (Baumgartner et al., 2016). For 2017 and 2018, the projections build upon the WIFO Economic Outlook of March 2017 (Glocker, 2017). The cut-off date for information accounted for in the projections is 17 March 2017. Policy measures proposed in the updated federal government programme of January 2017 (Bundeskanzleramt, 2017) have not been incorporated due to lack of more detailed information on their implementation. Likewise, data released by Statistics Austria after 17 March (e.g., on the private household and government accounts published end of March) could not be considered for the present projections. The calculations have been carried out using the WIFO macroeconomic model (Baumgartner – Breuss – Kaniovski, 2005). The international cyclical scenario was developed in a WIFO simulation of the Oxford Economic Forecasting (OEF) model, based on modified WIFO assumptions which depart from OEF's baseline global outlook of February 2017. For definitions used see "Methodological Notes and Short Glossary", <http://www.wifo.ac.at/wwadocs/form/WIFO-BusinessCycle-Information-Glossary.pdf>

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### 1. Global activity picking up

In its latest short-term forecast for 2017 and 2018 (Glocker, 2017), WIFO sees the state of the international economy more optimistically than in autumn of last year (Scheiblecker, 2016). We now expect a stronger revival of demand and output in the EU, the euro area (with annual average growth of real GDP 2017-2021 revised up by 0.2 percentage points from the October 2016 forecast) and in East-central Europe (+0.4 percentage points).

Despite the cyclically-induced higher energy demand worldwide and the cut in oil supply decided by OPEC in late November 2016, futures prices for Brent for 2021 were lower in March 2017 than six months earlier. WIFO has therefore revised down its oil price assumption (Brent) to an average 60 \$ per barrel for the period 2019-2021 (as compared with an expected increase to 64 \$ per barrel in the WIFO medium-term forecast of Autumn 2016). The time profile for the rise in market yields on Aus-

trian 10-year federal government bonds between 2017 to 2020 has been smoothed compared to the profile included in the Autumn 2016 forecast. The adjustment rests on the assumption that the ECB will terminate its bond purchase programme by the end of 2017 (without another extension) and that phasing-out will start earlier and prove more gradual.

Table 1: Main results

	Ø 2006-2011	Ø 2011-2016	Ø 2016-2021	2016	2017	2018	2019	2020	2021
	Year-to-year percentage changes								
Gross domestic product									
Volume	+1.2	+0.8	+1.7	+1.5	+2.0	+1.8	+1.7	+1.6	+1.6
Value	+3.0	+2.5	+3.3	+2.8	+3.3	+3.3	+3.3	+3.4	+3.4
Consumer prices	+2.2	+1.6	+1.8	+0.9	+1.7	+1.7	+1.7	+1.8	+1.8
GDP deflator	+1.8	+1.7	+1.6	+1.3	+1.4	+1.5	+1.6	+1.7	+1.8
Gross wages and salaries total <sup>1</sup>	+3.5	+3.1	+3.1	+2.8	+3.2	+3.1	+3.1	+3.1	+3.1
Per capita, volume <sup>2</sup>	-0.1	+0.3	+0.1	+0.5	-0.1	+0.1	+0.1	+0.1	+0.1
Employees <sup>3</sup>	+1.3	+1.2	+1.3	+1.4	+1.6	+1.3	+1.2	+1.2	+1.2
Persons in active dependent employment <sup>4</sup>	+1.0	+1.1	+1.3	+1.6	+1.6	+1.3	+1.2	+1.2	+1.2
	Ø 2007-2011	Ø 2012-2016	Ø 2017-2021	2016	2017	2018	2019	2020	2021
	Percent								
Unemployment rate									
Eurostat definition <sup>5</sup>	4.7	5.5	5.9	6.0	5.9	5.9	5.9	6.0	6.0
National definition <sup>6</sup>	6.6	8.2	8.9	9.1	8.9	8.9	8.9	9.0	9.1
	As a percentage of GDP								
Net exports	0.2	0.1	0.3	-0.4	0.3	0.3	0.3	0.2	0.2
General government financial balance (Maastricht definition)	-3.1	-1.8	-0.5	-1.4	-1.2	-0.7	-0.5	-0.3	-0.1
Cyclically-adjusted budget balance	-3.1	-1.4	-0.5	-0.9	-1.1	-0.6	-0.4	-0.2	-0.1
Structural budget balance	-3.0	-0.9	-0.4	-0.9	-0.9	-0.6	-0.3	-0.2	-0.1
Gross public debt	75.9	83.4	76.9	83.8	81.4	79.6	77.2	74.5	71.8
	As a percentage of disposable income								
Household saving ratio	10.5	7.7	9.3	8.5	9.0	9.3	9.4	9.4	9.4
	Ø 2006-2011	Ø 2011-2016	Ø 2016-2021	2016	2017	2018	2019	2020	2021
	Year-to-year percentage changes								
Trend output, volume	+1.2	+1.0	+1.5	+1.4	+1.4	+1.6	+1.6	+1.5	+1.5
	Ø 2007-2011	Ø 2012-2016	Ø 2017-2021	2016	2017	2018	2019	2020	2021
	As a percentage of trend output								
Output gap, volume	+0.1	-0.6	-0.1	-0.8	-0.3	-0.1	-0.1	-0.0	±0.0

Source: Statistics Austria, WIFO calculations. – <sup>1</sup> Excluding employers' contributions. – <sup>2</sup> Employees according to National Accounts definition, deflated by CPI. – <sup>3</sup> According to National Accounts definition. – <sup>4</sup> Excluding persons in valid employment contract receiving child care benefit or being in military service. – <sup>5</sup> According to Eurostat Labour Force Survey, as a percentage of total labour force. – <sup>6</sup> According to Public Employment Service Austria, as a percentage of total labour force excluding self-employed.

## 2. Domestic demand sustained by private consumption.

Driven by developments abroad, growth of real GDP should regain momentum also in Austria. Between 2017 and 2021, we expect an annual average increase of 1.7 percent (as compared with +1½ percent projected in Autumn 2016, and significantly higher than the 0.8 percent p.a. recorded for the period 2012-2016). The pace of economic growth would be in line with our assumption for the euro area average.

Exports are expected to gain 3¼ percent p.a. in volume, roughly 1¼ percentage points more than during the previous five-year period. According to the projection by Oxford Economic Forecasting of February 2017, Austrian exporters may be able to consolidate their foreign market position vis-à-vis the euro area average. With im-

ports (+3.1 percent p.a.) expected to be somewhat less buoyant than exports, the foreign trade contribution to GDP growth will remain positive.

Table 2: International fundamentals

	Ø 2006-2011	Ø 2011-2016	Ø 2016-2021
	Year-to-year percentage changes		
Gross domestic product, volume			
USA	+ 0.6	+ 2.1	+ 2.1
Euro area	+ 0.5	+ 0.7	+ 1.7
	Ø 2007-2011	Ø 2012-2016	Ø 2017-2021
		\$ per €	
Exchange rate	1.39	1.23	1.05
		\$ per barrel	
Oil price, Brent	84.4	83.1	59.2

Source: Eurostat, WIFO calculations.

Table 3: Components of aggregate demand, volume

	Ø 2006-2011	Ø 2011-2016	Ø 2016-2021	2016	2017	2018	2019	2020	2021
	Year-to-year percentage changes								
Consumption expenditure									
Private households <sup>1</sup>	+ 1.0	+ 0.3	+ 1.3	+ 1.5	+ 1.3	+ 1.2	+ 1.2	+ 1.2	+ 1.3
General government	+ 1.5	+ 1.0	+ 1.0	+ 1.3	+ 1.1	+ 1.0	+ 1.0	+ 1.0	+ 1.0
Gross fixed capital formation	+ 0.5	+ 1.3	+ 2.2	+ 2.9	+ 2.6	+ 2.4	+ 2.2	+ 2.1	+ 1.9
Machinery and equipment <sup>2</sup>	+ 2.7	+ 2.1	+ 3.0	+ 4.4	+ 3.5	+ 3.1	+ 2.9	+ 2.7	+ 2.6
Construction	- 1.7	+ 0.3	+ 1.4	+ 1.3	+ 1.6	+ 1.4	+ 1.4	+ 1.2	+ 1.1
Domestic demand	+ 1.0	+ 0.7	+ 1.5	+ 2.0	+ 1.8	+ 1.5	+ 1.4	+ 1.4	+ 1.4
Exports	+ 2.4	+ 1.9	+ 3.3	+ 1.7	+ 3.6	+ 3.4	+ 3.4	+ 3.2	+ 3.1
Imports	+ 2.2	+ 1.8	+ 3.1	+ 2.8	+ 3.3	+ 3.0	+ 3.1	+ 3.0	+ 3.0
Gross domestic product	+ 1.2	+ 0.8	+ 1.7	+ 1.5	+ 2.0	+ 1.8	+ 1.7	+ 1.6	+ 1.6

Source: Statistics Austria, WIFO calculations. – <sup>1</sup>Including private non-profit institutions serving households. – <sup>2</sup>Including weapon systems and other equipment.

Investment in business machinery and equipment should see altogether moderate gains of +3.0 percent p.a. (after +2.1 percent on average during the period 2012-2016), despite favourable financing conditions persisting. The cyclical recovery may peak in 2017 and abate in the following years, providing no lasting incentives for investment. Potential effects of the incremental investment premium ("Investitions-zuwachsprämie") for large companies and the option of accelerated depreciation of investment projects, as envisaged in the federal government programme from January 2017 (*Bundeskanzleramt*, 2017), have not been considered, since neither scope nor time frame of these measures had been sufficiently specified by the time the present forecast was made.

Population growth and the accompanying increase in the number of private households, as well as high real estate prices will further support private residential construction. Medium-term prospects for civil engineering, however, are clouded by the need to consolidate public budgets. Overall, the construction sector can expect moderate output growth of 1.4 percent p.a. over the forecast period (2012-2016 +0.3 percent).

Real disposable income of private households may gain 1½ percent p.a. up to the forecast horizon, a rate more than 1 percentage point higher than the average recorded for the period 2012-2016. The stronger momentum is mainly driven by the rise in employment by 1¼ percent p.a. Gross wages per capita will keep advancing sluggishly in real terms, by 0.1 percent p.a. between 2017 and 2021; the incomes of self-employed, however, should pick up from the last five-year period (net operating surplus 2017-2021 +3.7 percent; 2012-2016 +2.4 percent). With policy-controlled interest rates heading up, long-term real rates should turn positive towards the end of the

forecast horizon; as a result, returns on financial assets should provide a higher contribution to household disposable income growth.

The increase in the savings ratio from an average 7.7 percent over the period 2012-2016 to 9.3 percent for 2017-2021 owes to the net income gains from the tax reform of 2016. As from 2019, the savings ratio is expected to remain unchanged.

Till 2021, private consumption is projected to expand by 1¼ percent per year at constant prices, after only +0.3 percent between 2012 and 2016.

### 3. Moderate trend growth set to continue

According to WIFO's estimation based upon the calculation method developed by the European Commission, trend GDP growth in Austria over the period from 2017 to 2021 will be 1½ percent p.a., ½ percentage point higher than in the previous five-year period (2012-2016 +1 percent p.a.). The output gap (i.e. the relative deviation of actual from trend output) will narrow from -0.8 percent in 2016 to zero from 2018 onwards. Hence, the cyclical under-utilisation of productive capacity that started in 2013 will come to an end in 2018.

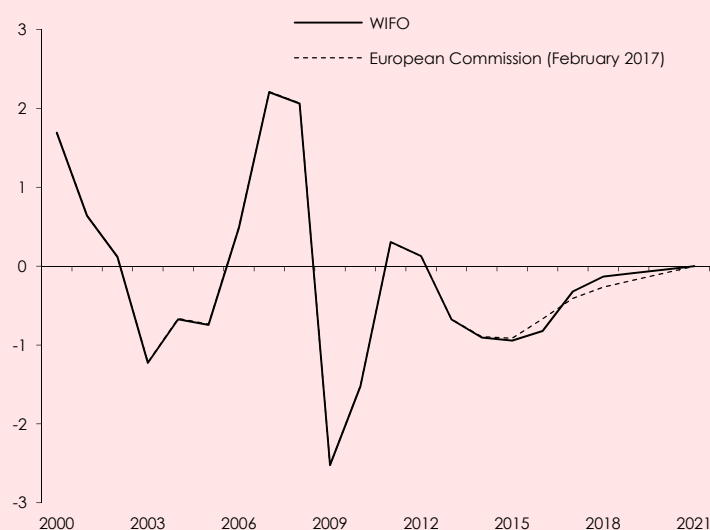
Table 4: Growth contributions of the input factors to trend output

		Ø 2007-2011	Ø 2012-2016	Ø 2017-2021	2016	2017	2018	2019	2020	2021
<i>WIFO estimate</i>										
GDP, volume	year-to-year percentage changes	+ 1.2	+ 0.8	+ 1.7	+ 1.5	+ 2.0	+ 1.8	+ 1.7	+ 1.6	+ 1.6
Trend output	year-to-year percentage changes	+ 1.2	+ 1.0	+ 1.5	+ 1.4	+ 1.4	+ 1.6	+ 1.6	+ 1.5	+ 1.5
Labour	percentage points	- 0.0	+ 0.2	+ 0.4	+ 0.4	+ 0.4	+ 0.4	+ 0.2	+ 0.3	+ 0.3
Capital	percentage points	+ 0.6	+ 0.5	+ 0.5	+ 0.5	+ 0.5	+ 0.5	+ 0.6	+ 0.6	+ 0.6
Total factor productivity	percentage points	+ 0.7	+ 0.4	+ 0.6	+ 0.5	+ 0.5	+ 0.6	+ 0.8	+ 0.6	+ 0.6
<i>European Commission estimate</i>										
GDP, volume	year-to-year percentage changes	+ 1.2	+ 0.8	+ 1.6	+ 1.5	+ 1.6	+ 1.6	+ 1.5	+ 1.7	+ 1.7
Trend output	year-to-year percentage changes	+ 1.2	+ 1.0	+ 1.5	+ 1.3	+ 1.3	+ 1.4	+ 1.4	+ 1.6	+ 1.6
Labour	percentage points	- 0.0	+ 0.1	+ 0.2	+ 0.3	+ 0.2	+ 0.3	+ 0.2	+ 0.3	+ 0.3
Capital	percentage points	+ 0.6	+ 0.5	+ 0.5	+ 0.5	+ 0.5	+ 0.5	+ 0.5	+ 0.6	+ 0.6
Total factor productivity	percentage points	+ 0.7	+ 0.4	+ 0.7	+ 0.5	+ 0.6	+ 0.6	+ 0.7	+ 0.7	+ 0.8

Source: European Commission, WIFO calculations.

Figure 1: Output gap

Volume, as a percentage of trend output



Source: European Commission, WIFO calculations.

#### 4. Rise in unemployment levelling off

The projected growth of output will allow the number of persons in dependent active employment (as recorded by the Austrian Social Security Board) to increase by an annual average 1.3 percent from 2017 to 2021, which will, however, provide only limited relief for the labour market, since the dependent labour force will grow at almost the same rate of 1.2 percent p.a. The increase in labour supply will largely be the result of the inflow of foreign workers (including recognised refugees and persons granted subsidiary protection), the opening of the Austrian labour market for Croatian citizens as from 2020-21, tighter rules of access to early retirement and invalidity pensions, and of the lasting increase in female labour force participation.

The unemployment rate should remain stable at 8.9 percent until 2019 and edge up thereafter to around 9.1 percent of the dependent labour force (national definition) by 2021, or 6.0 percent of the total labour force (Eurostat definition). For 2021, the number of jobless persons is projected at 380,000. The significant revision from the forecast of last autumn (jobless rate 2017 9.4 percent, 2019 9.8 percent) is mainly explained by stronger cyclical labour demand from 2017 (employment growth for 2017 +0.5 percentage points and as from 2018 onwards +0.2 percentage points p.a. up compared to the Autumn 2016 assessment). In addition, persons granted the refugee or subsidiary protection status will show up in the unemployment records with a much stronger lag as expected since they will be included only after having acquired a basic knowledge of German. The level of unemployment nevertheless remains high in a long-run perspective.

The present forecast does not incorporate the labour market measures cited in the Government Programme (*Bundeskanzleramt*, 2017), such as the "employment bonus" or the "employment action 20,000". If these measures were to be implemented during the forecast period, they should have a visible impact on the labour market (probably starting from 2018). In the event, overall employment may turn out higher and the jobless rate lower than suggested by this projection.

#### 5. Inflation expected persistently above the euro area average

Unit labour cost for the overall economy, a key determinant of domestic cost pressure, will rise by an annual 1.2 percent from 2017 to 2021. Gross real wages per capita will edge up by only 0.1 percent p.a., trailing behind the advance in labour productivity (+0.4 percent p.a.). Hence inflation will hardly be driven by labour costs. The positive gap in the inflation rate vis-à-vis the euro area average, while narrowing somewhat in coming years, will still remain due to the comparatively strong upward drift of services and administered prices in Austria.

With oil prices heading up again, mineral oil products will become more expensive, after having exerted a moderating effect on the overall inflation rate from 2014 to 2016. Going forward, from 2017 to 2021, the rise in the Consumer Price Index is expected at an annual average 1.8 percent (after +1.6 percent p.a. for the period 2012-2016).

#### 6. Gradual reduction of the government deficit, balanced budget within reach

Due to the revenue losses caused by the tax reform of 2015-16, which were not fully offset by increases in other taxes, expenditure restraint and anti-fraud measures, and because of expenditure overruns related to the inflow of refugees, the general government balance (according to the Maastricht definition) deteriorated from -1.0 percent of GDP in 2015 to -1.4 percent in 2016<sup>1</sup>. Starting from 2017, we expect

<sup>1</sup> The deficit and debt notification released by Statistics Austria on 30 March 2017 showing for 2016 a general government deficit of 1.6 percent of GDP could not be taken into account for the present forecast (cut-off

the deficit to steadily improve, with a virtually balanced general government budget in 2021 (–0.1 percent of GDP).

The expenditure of general government is projected to increase by an annual average 2.7 percent between 2017 and 2021. The upward drift is likely to accelerate, on account of higher spending on retirement benefits and other social transfers (2017–2021 +3.7 percent p.a., 2012–2016 +3.3 percent p.a.). The forecast assumes that consolidation efforts will be pursued at all government levels. Administrative costs and subsidies should thus rise only moderately. Public consumption is projected to advance at an annual 2.7 percent in nominal and 1.0 percent in real terms. The cost of servicing public debt will continue to relieve the expenditure side, despite long-term interest rates heading up and government debt rising until 2019. The ratio of interest expenditure to GDP will decline from 2.2 percent in 2016 to 1.6 percent by the forecast horizon.

The gradual decline of the general government deficit from 2017 onwards is primarily driven by public revenues (+3.3 percent p.a.) benefiting from the cyclical upswing and the progressive income tax schedule. No assumption has been made on any policy intervention to correct for fiscal drag. Indirect tax revenues are expected to grow at an annual rate of 2.4 percent, after +2.7 percent in the earlier five-year period. Social contribution revenues will increase in line with the projected steady growth of employment and wages.

The government debt ratio is forecast to recede from 83.8 percent of GDP in 2016 by 12 percentage points to 71.8 percent by 2021. This is a result of lower annual budget deficits and nominal GDP growth anticipated at 3.3 percent per year. In addition we assume that the debt burden will be eased by stock-flow adjustments, notably we assume that the liquidation of assets of public "bad banks", will yield on average additional revenues of 1.5 billion € per year.

According to the benchmark set by the EU, Austria's general government deficit in structural terms shall not exceed 0.45 percent of GDP as from 2016 (Medium-term Objective, MTO). The structural balance decreased from zero in 2015 to –0.9 percent of GDP in 2016 and is expected to remain unchanged in 2017; it should gradually narrow as from 2018 and keep within the –0.45 percent ceiling from 2019 onwards. Hence, a balanced budget in structural terms should be in reach towards the end of the forecast period.

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## 7. Risks to the forecast

From the international setting, most of the medium-term risks are adverse. Protectionist moves as announced in the USA, the withdrawal of the UK from the EU and lingering geo-political conflicts all carry the risk of undermining global economic growth. In the event, the otherwise favourable outlook for Austria's exports would be adversely effected, with negative consequences also for GDP growth.

The assumption of rising oil prices rests on the implementation of the agreed supply cuts by OPEC members and other major oil producers such as Russia. Should these supply cuts not occur to full extent, or be thwarted by higher oil production (e.g. in the USA), energy prices may rise less than anticipated, with a dampening impact on inflation.

The measures envisaged by the federal government to attenuate fiscal drag and to stimulate investment and employment have not been incorporated into the present forecast, as their implementation has not been sufficiently specified. Should these measures actually be introduced fully or in part within the projection horizon, household disposable income, private consumption and employment would turn out higher and unemployment lower than outlined here. The implicit boost to domestic

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date 17 March 2017). However, this deviation has no impact on the assessment of the government balance trend for the years from 2017 to 2021.

demand would in turn tend to raise GDP growth as well as tax and social contribution revenues. On the other hand, revenue shortfalls from the correction for fiscal drag and additional spending on investment and labour market support would weaken the government balance. The net effect would depend on the fiscal dividend from stronger economic activity and the (hitherto unspecified) actions taken to counter-finance the stimulation measures. The risks to the budgetary path retained for the present projections are thus deemed carrying a downward bias.

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