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# BUDGETARY AND LABOUR MARKET POLICIES FACING MAJOR CHALLENGES DESPITE FASTER GROWTH

## ECONOMIC OUTLOOK FOR 1999 TO 2001

*WIFO is upholding its projections for real GDP growth of 2.2 percent in 1999 and 2.8 percent in 2000. A first outlook into 2001 suggests demand and output may continue rising at an above-average pace of 2¾ percent. Unabated strength of domestic demand should be accompanied by livelier exports and industrial activity. Price stability is set to remain high. The crucial challenges for economic policy will be public sector borrowing and unemployment: on both accounts, the government will, from today's perspective, fail to meet its own targets.*

The present business cycle projections are the first ones to be based upon the new System of National Accounts ESA 1995. This implies a number of conceptual changes, and the new set of data established by Statistics Austria, is not yet complete. On the new data base, real GDP in the third quarter 1999 rose by around 3 percent from the year-earlier level. For the whole of 1999, WIFO maintains its projection of 2.2 percent, unchanged since last March.

In the first half of 1999, growth was driven almost entirely by domestic demand. A favourable employment trend, rising incomes and continued price stability strongly boosted private consumer spending. As from mid-year, lively consumer demand has been supplemented by a recovery of exports and industrial activity. Manufacturing output, having receded in the first semester, advanced by approximately 4 percent year-on-year in the third quarter.

In 2000, the Austrian economy should benefit from an improvement in international framework conditions: business activity, while remaining firm in the USA, is set to gain momentum in Europe, due to a weak euro as well as to domestic demand strength (notably in France, Spain and some of the smaller EU countries). In Germany, however, recovery remains subdued under the impact of a restrictive policy stance. Trad-

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*Table 1: Main results*

| | | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|---|
| | | Percentage changes from previous year | | | | |
| GDP | | | | | | |
| Volume | | + 1.2 | + 2.9 | + 2.2 | + 2.8 | + 2.8 |
| Value | | + 2.8 | + 3.5 | + 2.9 | + 3.6 | + 3.9 |
| Manufacturing[1], volume | | + 3.8 | + 3.4 | + 2.3 | + 4.3 | + 4.3 |
| Private consumption expenditure, volume | | + 0.1 | + 1.5 | + 2.3 | + 2.7 | + 2.3 |
| Gross fixed investment, volume | | + 0.8 | + 6.8 | + 3.3 | + 3.9 | + 4.2 |
| Machinery and equipment[2] | | + 4.6 | + 10.6 | + 6.0 | + 7.0 | + 7.0 |
| Construction | | − 1.6 | + 4.1 | + 1.3 | + 1.5 | + 2.0 |
| Exports of goods[3] | | | | | | |
| Volume | | +16.5 | + 8.1 | + 4.5 | + 7.0 | + 7.0 |
| Value | | +16.8 | + 8.4 | + 4.8 | + 8.1 | + 8.1 |
| Imports of goods[3] | | | | | | |
| Volume | | + 9.4 | + 7.1 | + 6.2 | + 6.5 | + 6.5 |
| Value | | +10.9 | + 6.6 | + 6.7 | + 8.1 | + 7.6 |
| Trade balance[3] | billion ATS | −75.2 | −67.4 | −86.8 | −94.0 | −96.7 |
| | billion euro | | | − 6.3 | − 6.8 | − 7.0 |
| Current balance | billion ATS | −64.1 | −56.8 | −61.2 | −64.7 | −57.6 |
| | billion euro | | | − 4.4 | − 4.7 | − 4.2 |
| | as a percentage of GDP | − 2.5 | − 2.2 | − 2.3 | − 2.3 | − 2.0 |
| Long-term interest rate[4] | in percent | 5.7 | 4.7 | 4.7 | 5.5 | 5.7 |
| Consumer prices | | + 1.3 | + 0.9 | + 0.5 | + 1.1 | + 1.0 |
| Unemployment | | | | | | |
| rate | percent of total labour force[5] | 4.4 | 4.7 | 4.4 | 4.2 | 4.1 |
| | percent of dependent labour force[6] | 7.1 | 7.2 | 6.7 | 6.5 | 6.2 |
| Dependent employment[7] | | + 0.4 | + 1.0 | + 1.2 | + 1.0 | + 0.9 |
| General government financial balance | as a percentage of GDP | − 1.9 | − 2.4 | − 2.1 | − 2.2 | − 1.9 |

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

ing partners in Eastern Europe are gradually ridding themselves of restraining forces on economic activity.

Austrian exports are benefiting not only from an accelerating expansion of foreign markets, but also from sizeable gains in competitiveness owing to substantial advances in productivity and pronounced wage moderation. Strong growth of merchandise exports (+7 percent in volume) is giving momentum also to manufacturing output (+4.3 percent) and investment in machinery and equipment (+7 percent). These estimates are confirmed by the very high level of business confidence, as sampled in the WIFO business survey.

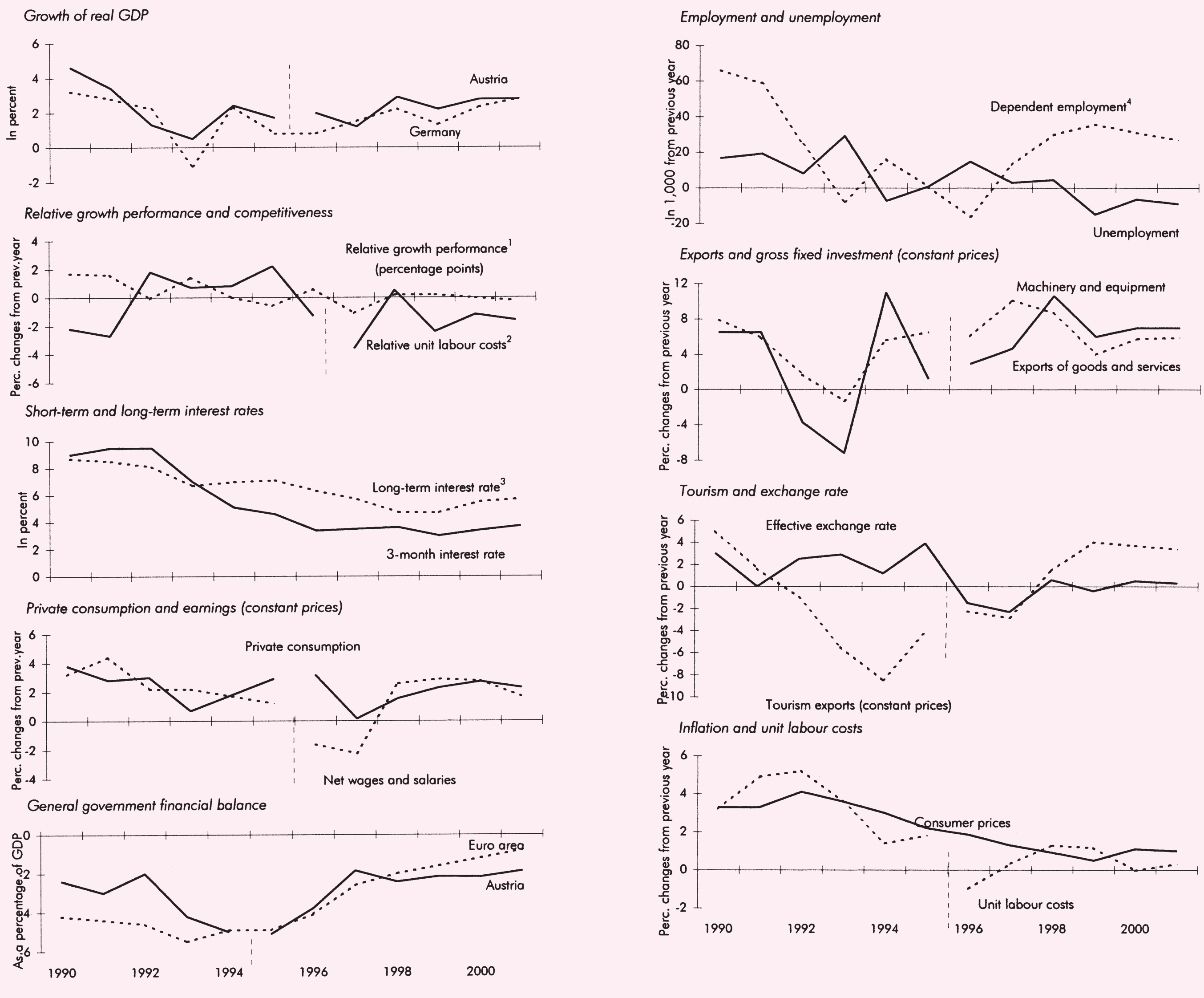
In 2000, private consumption will receive additional stimulus. Although gains in gross wages per capita will be squeezed by modest wage settlements, a generous tax reform and yet another raise in family benefits will make for a marked increase in net household income from employment and transfers (+2¾ percent adjusted for inflation). This will give strong upward drift to retail sales, and to consumer spending altogether. In 2001, consumer demand may move ahead at a slower pace, assuming a resumption of budgetary consolidation efforts. Construction activity is expected to remain lagging behind the overall trend in domestic demand, it being dragged down by a decline in residential building.

Government policy should take the opportunity offered by favourable prospects for economic growth to address the key problem areas, i.e., to strive for consolidation of government households, and for a reduction in unemployment. Cuts in private income and business taxes by some ATS 20 billion in the context of the tax reform 2000 will put heavy strain on public finances. With no Federal budget draft for 2000 having yet been submitted, the minister of finance has been led to cut ministries' uncommitted spending by a total of about ATS 20 billion. Incorporating this move, the present projections arrive at a total net government borrowing of 2.2 percent of GDP for 2000, and of 1.9 percent for 2001. EMU obligations and, even more, the need to create scope for the operation of automatic fiscal stabilisers in adverse cyclical periods require therefore further action of budgetary retrenchment.

The Federal government has not only set medium-term targets for fiscal policy, in the Stability Programme, but also for the labour market up to 2002, with the 1997 National Action Plan for Employment. Dependent employment is to be raised by 100,000, the unemployment rate to be lowered to 3½ percent. The projected pick-up in economic growth should make for a strong increase in the number of jobs, allowing the employment target to be reached already by 2001 – if only, however, with regard to the number of employment contracts, and not of full-time equivalents, given the strong expansion of part-time work. The rate of unemployment (EU definition) will decline to 4.1 percent of the labour force by 2001, a further fall to 3½ percent in 2002 may be achieved only under the assumption of a further increase in financial resources for active labour market and training measures, and of stronger emphasis being put on the creation of full-time jobs.

The Austrian economy has entered a period of marked upturn, driven by both domestic and export demand. Supply constraints are unlikely to emerge over the projection period, given strong investment activity and considerable labour market reserves (high unemployment and growing labour supply). This is confirmed also by the prospects for sustained price stability – consumer price inflation being expected at an annual rate of only 1.1 percent in 2000. The risks of the present projections are located at the international level. Economic activity in the two most important trading partner countries, Germany and Italy, is distinctly lagging behind that in most other EU countries. In both countries, monetary and fiscal policies have turned restrictive in the early stages of a still hesitant recovery. The situation in the USA is marked by strong macro-economic imbalances in the form of a high current account deficit and an extraordinarily low saving ratio of private house-

*Figure 1: Indicators of economic performance*




Break in series: ESA 1979 / ESA 1995

[1] Vis-à-vis the euro area. – [2] Manufacturing; in a common currency vis-à-vis trading partners. – [3] 10-year central government bonds (benchmark). – [4] Excluding parental leave and military service.

holds; if the latter were to revert to a normal level, there would be a risk for an abrupt end to the extraordinarily long boom period.

## IMPORTANT MACRO-ECONOMIC IMBALANCES IN THE USA

Strength of domestic demand in the USA continues to exceed most observers' expectations, with no signs of weakening yet being apparent. For the fourth consecutive year, GDP in 1999 rose by about 4 percent. The strong momentum not only contributes importantly towards stabilising the world economy, but is also the key factor for lower unemployment and the consolidation of public finances. Yet, considerable macro-economic imbalances have been building up over the last years. In particular, the private household saving ratio has fallen sharply, from 8 percent in the early 1990s to only 2 percent in 1999. The propensity to spend more out of current income has to be seen in the context of the massive rise in share prices, which currently seem clearly overvalued. A second imbalance has opened up on the external front. The strongly negative financial balance of the private sector is accompanied by marked surpluses of the public and the foreign sectors – the current account deficit amounts to USD 338 billion (3½ percent of GDP), implying that domestic investment is largely financed from foreign funds.

The low private saving ratio is not sustainable over the medium run. A possible stock market correction would probably make for the saving ratio to revert to its long-term average and for consumer, but also investment demand to cool off significantly. This will not necessarily lead to a recession, particularly not if monetary and fiscal policies are ready to use their respective scope for counter-action. Under present assumptions, U.S. GDP will expand by an inflation-adjusted 3 percent in 2000, and by 2 percent in 2001.

## EXCHANGE RATE VOLATILITY BETWEEN EURO, DOLLAR AND YEN

*The strength of the dollar vis-à-vis the euro corresponds to the growth and interest rate differentials between the two areas, and contributes towards a pick-up in export activity in Europe. With the business cycle recovery in the EU gaining ground, interest rates and the euro exchange rate are expected to rise during 2000 and 2001.*

The impressive dynamism of the U.S. economy and, related to it, the positive interest rate differential vis-à-vis Europe are the major causes of the weakness of the euro – or rather the strength of the dollar. The depreciation of the euro by some 15 percent since the beginning of the year have, from a cyclical point of view, been helpful in overcoming the weakness at the turn of 1998-99 in Europe. It markedly enhances price-competitiveness of European exports in the buoyant U.S. market and in contested third markets, thereby contributing towards export recovery.

In early November, the ECB has raised interest rates. This move has come at a rather untimely moment, given the still early stage of the recovery, the absence of inflationary pressure beyond higher oil prices, and considerable uncertainty surrounding the development of the money supply M3. Yet, the cyclical recovery in Europe, accompanied by growth deceleration in the USA, should make for a rebounding euro exchange rate over the next two years.

The projection of short-term interest rates implies that they will be largely influenced by inflation expectations and the cycle. Assumptions for both variables suggest three-months rates will edge up to 3½ (2000) and 3¾ percent (2001), primarily driven by strengthening economic growth. Long-term interest rates in Europe are deemed determined by their levels in the USA, expected to rise further only slightly, and by European monetary policy.

*Table 2: World economy*

| | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|
| | Percentage changes from previous year | | | | |
| *Real GDP* | | | | | |
| Total OECD | + 3.2 | + 2.2 | + 2.8 | + 2.8 | + 2.5 |
| USA | + 4.5 | + 4.3 | + 4.0 | + 3.0 | + 2.0 |
| Japan | + 1.4 | − 2.8 | + 1.0 | + 1.3 | + 2.0 |
| EU | + 2.5 | + 2.6 | + 2.0 | + 2.8 | + 3.0 |
| Euro area | + 2.3 | + 2.7 | + 2.0 | + 2.8 | + 3.0 |
| Germany | + 1.5 | + 2.2 | + 1.3 | + 2.3 | + 2.8 |
| Central Eastern Europe[1] | + 5.1 | + 3.4 | + 2.5 | + 3.8 | + 4.5 |
| *World trade, volume* | +10.0 | + 5.1 | + 4.5 | + 6.5 | + 6.0 |
| OECD exports | +11.3 | + 5.4 | + 3.5 | + 6.3 | + 6.0 |
| Intra-OECD trade | +11.3 | + 7.9 | + 5.5 | + 6.3 | + 6.0 |
| *Market growth*[2] | + 8.3 | + 7.8 | + 4.0 | + 5.8 | + 5.5 |
| *Primary commodity prices, in USD* | | | | | |
| HWWA index, total, 1990 = 100 | − 2.0 | −23.0 | +13.0 | +17.0 | + 1.0 |
| Excluding energy | + 1.0 | −13.0 | − 8.0 | + 7.0 | + 3.0 |
| *Crude oil prices* | | | | | |
| Average import price (cif) for OECD countries, USD per barrel | 19.1 | 12.7 | 17.0 | 21.0 | 21.0 |
| *Exchange rate*, USD per ECU or euro | 1.134 | 1.121 | 1.070 | 1.10 | 1.12 |

[1] Poland, Slovakia, Slovenia, Czech Republic, Hungary. – [2] Real import growth of trading partners weighted by Austrian export shares.

Benchmark 10-year Federal bond yields may thus move up to 5½ and 5¾ percent, respectively.

The appreciation of the yen against the dollar and the euro – 11 and 30 percent, respectively, since the beginning of the year – reflects economic developments and policy requirements much less than does the euro-dollar exchange rate. In Japan, growth remains anaemic and heavily dependent on large-scale public expenditure. More recently, however, there have been signs of a timid recovery in private consumption, and, with major trading partners in South-East Asia heading for an economic upturn, exports should also regain momentum. Such prospects are encouraging international investors in search of appropriate placements, following the financial crises in South-East Asia, Russia and Latin America, to a return to the Japanese stock market. The ensuing appreciation of the yen, at the same time, acts as a brake on the start of a business cycle recovery.

## CONSIDERABLE GROWTH DIFFERENTIAL BETWEEN TRANSFORMATION COUNTRIES

The catching-up process of East-European transformation countries is moving at different speed. Institutional, economic and social problems are particularly severe in Russia. The sharp devaluation of the rouble in the course of last year's financial crisis and the rise in oil prices have given incentives to industrial production and provide relief for the current account and the government budget; still, a sustained recovery is not yet in sight.

In East-Central Europe, high current account deficits frequently require restrictive policies to rein in domestic demand – such as in 1998-99 in the Czech Republic, and 1999-2000 in Slovakia. Average GDP growth for the five countries (Poland, Czech Republic, Slovakia, Hungary, Slovenia) decelerated to a low 2½ percent rate in 1999.

The external imbalances derive from the high import demand for Western consumer and investment goods in the context of the catching-up process, and from weak demand for products from Eastern Europe in the Western part of the continent. Capital inflows, notably in the form of foreign direct investment, although strong, are still insufficient as to cover the deficit on goods and services transactions. Currently, the external deficit is widening particularly strongly in Poland.

For 2000 and 2001, the projections for this group of countries nevertheless expect a strengthening of growth, as the recovery in the EU should stimulate imports from Eastern Europe and ease these countries' balance-of-payments constraints.

## UNEVEN EXPANSION ACROSS THE EU

*In spring 1999, a cyclical upswing has come under way in Europe, which should reach its peak not until 2001. Exports are picking up markedly in all EU countries. The pronounced growth differential between France, Spain and several smaller countries on the one hand, and Germany and Italy on the other, are explained mainly by the different strength of domestic demand.*

In Europe, the cyclical "pause" around the turn 1998-99 has been overcome. Over the last summer, the export-led forces of recovery have gained further strength. Notably exports to the USA and to Asia picked up, due to lively import demand from these areas and favourable exchange rate movements. As a consequence, confidence indicators and industrial production have rebounded since the beginning of 1999. In the majority of the EU countries, consumer demand and construction have been rising strongly since 1998. Consumer confidence, which is closely correlated with trends in the labour market, is at a long-time high.

Growth of GDP in the EU, averaging 2 percent in volume terms in 1999, is set to accelerate to a rate of 2¾ percent, given the recovery in exports and continued firm domestic demand. On present assumptions, a further increase to 3 percent in 2001 appears likely. However, marked growth differentials exist between the EU countries. Demand and output rise above-average in Southern Europe (except for Italy), Scandinavia (with the exception of Denmark), Ireland and the Netherlands. Among the larger EU countries favourable developments in France stand out. Since 1998 already, GDP has grown by around 3 percent per year (at constant prices), roughly 1 percentage point faster than in Germany and slightly above the EU average. This is owed in particular to lively consumer demand, which is benefiting from sizeable employment gains and an accommodating budgetary policy stance.

In Germany, sluggishness, which has had its grip on the economy ever since the 1993 recession, is set to persist. In 1999, real GDP rose by a mere 1¼ percent. More than others, Germany has been affected by weakness in major export markets; the construction industry is struggling with an adjustment crisis following the reunification boom; private consumption and employment remain in stagnation. Dynamic, however, has been investment in machinery and equipment, despite widespread complaints about Germany's alleged deficiencies as a business location. During the second half-year, exports have rebounded markedly. The incipient recovery is now being restrained by policy in an early stage. On the one hand, ECB monetary policy is being restrictive in the face of Germany's persistent weakness of growth; on the other hand, a fiscal "package" is taking effect on 1 January 2000, which provides for measures of consolidation to the amount of ¾ percent of GDP. For 2000, therefore, growth may not be expected to exceed 2¼ percent, falling again clearly below the EU average, and supported mainly by exports and private investment. Only for 2001, an acceleration to a rate of 2¾ percent is projected.

The second country lagging the European business cycle is Italy, where exports suffered a particularly severe slump in 1999. In addition, a very restrictive budgetary policy produces high primary surpluses in government accounts (balance of current revenues and expenditure excluding debt service payments). GDP growth in 1999 did not exceed 1 percent. The marked fall in interest payments of enterprises and government bodies, together with a cyclical rebound in exports, should as from now allow growth to pick up gradually (2000 +2 percent, 2001 +2½ percent).

## STRONG UPTURN IN EXPORT AND INDUSTRIAL ACTIVITY

In Austria also, exports have gained considerable momentum since early 1999. Earnings from foreign sales (according to Austrian National Bank figures), while falling

*Table 3: Productivity*

| | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|
| | Percentage changes from previous year | | | | |
| *Total economy* | | | | | |
| Real GDP | + 1.2 | + 2.9 | + 2.2 | + 2.8 | + 2.8 |
| Employment[1] | + 0.5 | + 0.9 | + 0.9 | + 0.8 | + 0.7 |
| Productivity (GDP per employment) | + 0.7 | + 1.9 | + 1.2 | + 1.9 | + 2.0 |
| *Manufacturing* | | | | | |
| Production[2] | + 3.8 | + 3.4 | + 2.3 | + 4.3 | + 4.3 |
| Employees | − 1.4 | + 0.1 | − 0.7 | − 0.1 | ± 0.0 |
| Productivity per hour | + 5.5 | + 3.2 | + 3.7 | + 4.4 | + 4.3 |
| Working hours per day for employees | − 0.1 | + 0.1 | − 0.7 | ± 0.0 | ± 0.0 |

[1] Dependent and self-employed according to National Accounts. – [2] Value added.

1½ percent below the year-earlier level in the first quarter, rose by 7 percent in the third quarter. This mirrors the recovery of demand in Western European trading partner countries, as well as strong price-competitiveness of Austrian suppliers. Unit labour costs have fallen by an aggregate 7 percent since 1995 vis-à-vis Austria's trading partners. By contrast, exports to Eastern Europe have been declining, mainly due to demand weakness in the Czech and the Slovak Republics.

*Exports and manufacturing output proved still very weak in the first semester 1999. Since spring, however, business judgements in the regular WIFO Survey on order books and on prospects for production and prices have improved substantially. For 2000 and 2001, solid growth of merchandise exports, goods output and investment in machinery and equipment may be expected.*

With the cyclical upswing in the EU, export market growth will accelerate notably in 2000, towards a projected 6 percent. At the same time, Austrian manufacturers should boost their price-competitiveness by a further considerable margin, due to strong productivity advances – by an estimated 4½ percent on an hourly basis – as well as very moderate wage increases, implying a fall in unit labour costs by 1¾ percent. Thereby, substantial gains in market shares may be achieved. In such circumstances, merchandise exports should exhibit strong momentum, rising at a 7 percent annual rate (in volume) throughout the projection period.

The pick-up of exports is set to stimulate manufacturing output, as already signalled by the WIFO business survey among industrial firms. Responses on the order situation and on the expectations for production and sales prices point to a significant improvement in the business climate, particularly for producers of investment goods and of basic materials. They also warrant extrapolation of the positive trend into the near future. Manufacturing may thus be able to increase its value added in 2000 by over 4 percent at constant prices. Favourable sales expectations, a good profit situation, but also mounting competitive pressure should induce firms to timely renewal of their capital stock: investment in machinery and equipment is projected to increase by a strong 7 percent in 2000.

## CURRENT ACCOUNT DEFICIT TO REMAIN HIGH

In 1999, the current account deficit will have widened to around ATS 60 billion. Strong domestic demand has driven up imports, while higher oil prices acted as a substantial drag on the trade balance. Import demand is set to stay lively in 2000. Buoyancy of private consumption and investment is not expected to abate, the oil bill will be higher again on a year-on-year basis, and the export recovery will accelerate the import of commodities and semi-manufactures. On the other hand, the surplus on tourism services should increase, due to both higher earnings from foreign visitors and an inflation-adjusted decline in spending on travel by Austrians. The balance on other service transactions should also move into higher surplus.

The current account is being weakened by sizeable capital outflows via interest and dividend income, as well as returns from foreign direct investment resulting from the strong capital inflows of the past years (Austria being an attractive location for investment). According to accounting conventions, earnings from capital of foreign owners which are reinvested in Austria are also recorded as outflow in the income balance (and as inflow in the capital balance).

In 2001, the current account deficit may slightly diminish, as business activity in Europe should remain strong, while domestic demand may abate somewhat under the impact of efforts to consolidate public finances.

## STRONG GROWTH IN PRIVATE CONSUMPTION

*In spite of narrow wage increases, net real disposable income from employment and transfers will post strong gains in 2000, as a result of sizeable tax cuts and more generous family benefits. This will give rise to a marked expansion of private consumption.*

In 1999, private household consumption, rising by 2¼ percent in volume, provided major support to overall

*Table 4: Private consumption and earnings*

| | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|
| | Percentage changes from previous year, volume | | | | |
| Private consumption expenditure | + 0.1 | + 1.5 | + 2.3 | + 2.7 | + 2.3 |
| Durables | − 3.5 | + 1.9 | + 6.0 | + 4.5 | + 2.6 |
| Non-durables and services | + 0.7 | + 1.5 | + 1.8 | + 2.4 | + 2.3 |
| Net wages and salaries | − 2.3 | + 2.6 | + 2.9 | + 2.8 | + 1.7 |

activity. The slight revision to the projection of last autumn is related primarily to the transition to the new ESA 1995 National Accounts, which newly include the fast-rising private expenditure on telecommunication services. Markedly rising employment, higher incomes and stable prices continue to offer substantial gains in purchasing power. Net disposable income from employment and social transfers advanced by around 3 percent in real terms. Consumer confidence maintains a high level. In 2000, moderate wage settlements (allowing gross earnings per employee to rise by only 1¾ percent in nominal terms) will squeeze income gains considerably. However, a further increase in family benefits and a lowering of the tax burden will give an additional boost to private disposable income and consumption. Spending by domestic consumers is projected to increase by an inflation-adjusted 2¾ percent, with demand for durables expected to rise even faster. Retail sales, benefiting not only from strong consumer sentiment, but also from higher spending by foreign visitors, may advance by 3 percent in volume in 2000.

In 2001, net incomes from employment and transfers should rise at a slower pace. The stimulus from the tax reform will taper off, and new measures of fiscal consolidation are to be expected. Private consumption may therefore lose some momentum (+2¼ percent). As the new ESA 1995 data base is still incomplete, no private household saving ratio can as yet be calculated. Comparing the trend of consumer expenditure with that of net household income (excluding capital and entrepreneurial income) suggests however, that the saving ratio maintains an upward tendency in 1999 and 2000.

Growth rates for construction investment and output, expected in the range between 1 and 2 percent, will remain below that of overall GDP. Demand for new residential building remains sluggish. Renovation activity, which was still lively in 1999, may benefit from a partial shift in the allocation of housing construction subsidies, thereby offsetting the negative impact of special tax incentives being phased out. Civil engineering will receive stimulus from large-scale public investment in the railroad and road infrastructure which, being financed off-budget, is little affected by fiscal restraint. Construction of commercial buildings and office space should flourish as a consequence of strong private-sector business activity.

*Table 5: Earnings and international competitiveness*

| | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|
| | Percentage changes from previous year | | | | |
| Gross earnings per employee | + 0.7 | + 2.8 | + 2.3 | + 1.8 | + 2.3 |
| Gross real earnings per employee | − 1.1 | + 2.1 | + 1.8 | + 0.7 | + 1.3 |
| Net real earnings per employee | − 3.6 | + 1.6 | + 1.2 | + 1.5 | + 0.8 |
| Net wages and salaries | − 0.5 | + 3.3 | + 3.4 | + 3.9 | + 2.7 |
| Unit labour costs | | | | | |
| Total economy | + 0.3 | + 1.3 | + 1.2 | − 0.0 | + 0.3 |
| Manufacturing | − 4.0 | − 0.7 | − 0.7 | − 1.8 | − 1.4 |
| Relative unit labour costs[1] | | | | | |
| Vis-à-vis trading partners | − 3.6 | + 0.5 | − 2.4 | − 1.2 | − 1.6 |
| Vis-à-vis Germany | + 1.2 | + 1.5 | − 2.4 | − 0.9 | − 1.7 |
| Effective exchange rate – manufactures | | | | | |
| Nominal | − 1.8 | + 0.6 | − 0.5 | + 0.3 | + 0.2 |
| Real | − 2.5 | ± 0.0 | − 1.2 | − 0.2 | − 0.5 |

[1] Manufacturing, in a common currency; minus sign indicates improvement of competitiveness.

## BUDGETARY DEVELOPMENTS SHAPED BY TAX REFORM AND CUTS IN DISCRETIONARY SPENDING

*Current assumptions on budgetary trends are determined by prospective growth of GDP, the tax reform and announced cuts in spending items not subject to legal commitment. They yield a projected general government deficit of 2.2 percent of GDP for 2000, and of just below 2 percent for 2001. Further measures of fiscal retrenchment will prove necessary.*

The tax reform taking effect as from 1 January 2000, provides for generous cuts in personal and corporate income taxes. When fully implemented, direct costs to the budget will amount to over ATS 20 billion. At the same time, the reform will give incentives to private consumption, which will produce additional indirect and direct tax revenues. The net result will be a market increase in government net borrowing, which by 1999 had gone down to around 2 percent of GDP. Reacting to the tighter budgetary situation in prospect, the minister of finance reduced discretionary spending by ministries by some ATS 20 billion in the provisional Federal budget for 2000. A stance of fiscal restraint more in line with the need for structural budgetary adjustment can only be adopted by the new Federal government to be formed, when submitting a definitive budget draft.

The present projections have incorporated the cuts in public consumption recently decided. Federal outlays for current purchases, investment and subsidies are being reduced markedly (nearly one-third of these measures having already been factored into the WIFO projections of

*Table 6: Labour market*

| | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|
| | Changes from previous year, in 1,000 | | | | |
| *Demand for labour* | | | | | |
| Civilian employment | + 8.8 | +22.1 | +31.0 | +31.2 | +27.8 |
| Dependent employment[1] | + 8.3 | +21.1 | +30.0 | +29.3 | +25.8 |
| Excluding parental leave and military service | +12.8 | +29.8 | +35.7 | +31.0 | +27.0 |
| *Percentage changes from previous year* | + 0.4 | + 1.0 | + 1.2 | + 1.0 | + 0.9 |
| Parental leave and military service[1] | − 4.4 | − 8.7 | − 5.7 | − 1.7 | − 1.2 |
| Foreign workers | − 1.6 | − 0.2 | + 6.8 | + 9.0 | + 7.0 |
| Self-employed[2] | + 0.5 | + 1.0 | + 1.0 | + 1.9 | + 2.0 |
| *Labour supply* | | | | | |
| Total labour force | +11.7 | +26.5 | +16.0 | +24.7 | +18.8 |
| Foreign | − 1.7 | + 0.7 | + 5.7 | + 7.0 | + 5.5 |
| Migration of nationals | + 5.4 | + 3.9 | + 3.0 | + 2.0 | + 1.5 |
| Indigenous | + 8.0 | + 21.9 | + 7.3 | +15.7 | +11.8 |
| *Surplus of labour* | | | | | |
| Registered unemployed[3] | + 2.8 | + 4.4 | −15.0 | − 6.5 | − 9.0 |
| in 1,000 | 233.3 | 237.8 | 222.8 | 216.3 | 207.3 |
| Unemployment rate | | | | | |
| According to Eurostat (percent of total labour force) | 4.4 | 4.7 | 4.4 | 4.2 | 4.1 |
| According to AMS (percent of total labour force | 6.4 | 6.5 | 6.0 | 5.8 | 5.5 |
| According to AMS (percent of dependent labour force | 7.1 | 7.2 | 6.7 | 6.5 | 6.2 |
| Participation rate[4] | 67.2 | 67.6 | 67.7 | 67.9 | 68.1 |
| Employment rate[5] | 62.9 | 63.2 | 63.6 | 64.0 | 64.3 |

[1] According to Association of Austrian Social Security Bodies. – [2] According to WIFO. – [3] According to Labour Market Service. – [4] Total labour force as a percentage of active population (aged 15 to 64). – [5] Employment as a percentage of active population (aged 15 to 64).

*Table 7: Key policy indicators*

| | | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|---|
| *Fiscal policy* | | | | | | |
| Central government net balance | billion ATS | −67.2 | −66.0 | −69.0 | −70.0 | −65.0 |
| | as a percentage of GDP | − 2.7 | − 2.5 | − 2.6 | − 2.5 | − 2.2 |
| General government financial balance | as a percentage of GDP | − 1.9 | − 2.4 | − 2.1 | − 2.2 | − 1.9 |
| | | In percent | | | | |
| *Monetary policy* | | | | | | |
| 3-month interest rate | | 3.5 | 3.6 | 3.0 | 3.4 | 3.7 |
| Long-term interest rate[1] | | 5.7 | 4.7 | 4.7 | 5.5 | 5.7 |
| Bond yield, average | | 4.8 | 4.4 | 4.1 | 5.0 | 5.2 |
| | | Percentage changes from previous year | | | | |
| *Effective exchange rate* | | | | | | |
| Nominal | | − 2.3 | + 0.6 | − 0.4 | + 0.5 | + 0.3 |
| Real | | − 3.3 | − 0.2 | − 1.3 | − 0.2 | − 0.5 |

[1] 10-year central government bonds (benchmark).

last autumn). These measures should allow to confine net government borrowing to a ratio of 2.2 percent of GDP in 2000. In 2001, this ratio may abate to 1.9 percent, assuming continued strict restraint in public consumption. Households of the Federal states are assumed to show an aggregate surplus of 0.3 percent of GDP.

According to the projections, the general government deficit continues to overshoot substantially the targets laid down in the Stability Programme (net borrowing ratios of 1.7 percent in 2000 and 1.5 percent in 2001). Thus, efforts at fiscal consolidation will be required also over the medium term – in order to honour commitments on the European level and, more importantly, to create scope for fiscal counter-action in periods of adverse economic and employment conditions.

## LABOUR MARKET POLICY TARGETS UNLIKELY TO BE FULLY ACHIEVED

The situation on the labour market, as measured by figures of employment and unemployment, is improving rapidly. In 1999, nearly 36,000 (+1.2 percent) additional jobs have been created, allowing for a new all-time high in employment to be reached. The number of registered unemployed fell by 15,000.

Structural indicators convey a somewhat more nuanced picture. The increase in employment over the last years has been confined to the creation of part-time jobs, while the number of full-time jobs declined. In 1999, however, also full-time employment increased, contributing towards a fall in unemployment. Even more important have been a reinforcement of training activities and higher spending on employment subsidies (e.g., wage subsidies for a limited period of time to firms hiring long-term unemployed). Outlays for active labour market measures accounted for 18 percent of total public expenditure on labour market policy. Those out of work, whose benefits have been withdrawn – frequently persons who declined to participate in "job coaching" activities – are henceforth no longer counted as unemployed.

*Stronger economic growth will make for substantial employment gains. The major part of new jobs created will be part-time in services branches. Unemployment is falling steadily, mainly due to reinforced education and training activities. The rate of unemployment in 2001 is projected at 6.2 percent on national definitions, and at 4.1 percent according to the methodology adopted by the EU Labour Force Survey.*

With export and industrial activity recovering, employment in manufacturing will no longer decline in 2000 and 2001; key sectors of technical manufactures (machine tools, vehicles industries, etc.) may add to personnel. Employment growth is set to remain strong: +31,000 (dependent workers and employees, excluding people in military service and on maternity leave) in 2000, +27,000 in 2001. The bulk of new jobs will be created in the service sector, and part-time work will likely remain the predominant form. Yet, accelerating economic growth will also allow full-time jobs to increase, such that overall employment will rise over the next years even when calculated in full-time equivalents.

The stronger momentum of economic growth is closely associated with an increase in employment. Somewhat less close is the connection with a decline in unemployment. Many jobless people are looking for a full-time job, older job-seekers are often difficult to place, problems of inadequate qualification are becoming more frequent. Additional part-time jobs are often filled with new entrants to the labour force. While no budget figures for labour market policy have as yet been fixed, the projections assume that at least in 2000 no major cuts will be applied to labour market training, qualification measures and wage subsidies. In that case, unemployment may further decline to 216,000 on annual average 2000. While there is still considerable uncertainty about institutional framework conditions prevailing in 2001, the projected cyclical upswing should allow unemployment to fall further. The unemployment rate could by then average 4.1 percent of the total labour force, according to the EU Labour Force Survey, or 6.2 percent of the dependent labour force, following traditional Austrian definitions.

When deciding on the National Action Plan for Employment in 1997, the Federal government has set itself two targets for the labour market up to 2002: for employment to rise by 100,000, and for the unemployment rate to fall to 3½ percent. The present projections suggest that the employment target may be attained already by 2001 – albeit only with regard to the number of employment contracts and not of full-time equivalents. The unemployment target may, from today's perspective, be achieved only under the assumption of a reinforcement of policy action. The latter is required also in order to comply with the "employment policy guidelines", which define their own targets at the EU level – such as an increase in the proportion of unemployment participating in active labour market policy measures to at least 20 percent of the total.

## PRICE STABILITY SEEN MAINTAINED UNTIL 2001

Price stability is not seen jeopardised by the strong upward drift in oil prices. Although the year-on-year increase in consumer prices has slightly accelerated in recent months, the average 1999 rate of inflation stands at a low 0.5 percent.

The effect of higher oil prices will be felt more strongly in 2000, amounting to ¼ percentage point on the consumer level. On the other hand, the liberalisation of electricity networks puts downward pressure on the prices for other sources of energy. Food prices are projected to edge up somewhat more than in 1999. The hike in rents is expected to level off, given an over-supply of dwellings. Modest wage settlements will keep overall unit labour costs stable, which will thus exert no upward pressure on prices. Consumer price inflation in 2000 is projected to average 1.1 percent.

Price stability will also be preserved in 2001. Energy prices should no longer exert upward pressure, and other consumer goods are unlikely to register major price hikes. The rate of inflation may stay around 1 percent.

Cut-off date: 15 December 1999