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 **ÖSTERREICHISCHES INSTITUT FÜR
WIRTSCHAFTSFORSCHUNG**

**Cyclical Upswing, but Lasting
Uncertainty
Economic Outlook for 2010 and 2011**

September 2010

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Economic Outlook for 2010 and 2011

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Austrian Institute of Economic Research

Abstract

Benefiting from the depreciation of the euro in the first half of the year, euro area exports should keep their upward trend in the remainder of 2010. At the same time, however, economic growth is set to slow down somewhat in the USA and in Asia. In 2011, the cyclical upswing in the euro area will maintain a moderate pace. While industrial activity should prove resilient, the high government deficits and imminent consolidation moves, hesitant private investment behaviour, the need for financial sector reform and macroeconomic imbalances within the euro area will weigh on demand and output growth. For Austria, WIFO expects real GDP to expand by 2 percent in 2010 and 1.9 percent in 2011. The revival of business activity will contribute to improvements in the labour market and in public finances. By 2011, the unemployment rate should ease to 6.8 percent of the dependent labour force, and the government deficit, including the planned consolidation measures, should narrow to 3.5 percent of GDP.

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Cyclical Upswing, but Lasting Uncertainty

Economic Outlook for 2010 and 2011

Benefiting from the depreciation of the euro in the first half of the year, euro area exports should keep their upward trend in the remainder of 2010. At the same time, however, economic growth is set to slow down somewhat in the USA and in Asia. In 2011, the cyclical upswing in the euro area will maintain a moderate pace. While industrial activity should prove resilient, the high government deficits and imminent consolidation moves, hesitant private investment behaviour, the need for financial sector reform and macroeconomic imbalances within the euro area will weigh on demand and output growth. For Austria, WIFO expects real GDP to expand by 2 percent in 2010 and 1.9 percent in 2011. The revival of business activity will contribute to improvements in the labour market and in public finances. By 2011, the unemployment rate should ease to 6.8 percent of the dependent labour force, and the government deficit, including the planned consolidation measures, should narrow to 3.5 percent of GDP.

With some delay vis-à-vis the USA and Asia, a strong upturn in industrial activity has now set in also in the euro area. On the back of a weaker euro exchange rate and the unabated booming demand from Far East, exports powered ahead in the second quarter 2010 and fuelled internal demand, despite the turbulences of April and May triggered by the high government deficits in several southern EU countries. In the same period, euro area GDP rose by 1.0 percent from the first three months of the year. Particularly strong growth in Germany (+2.2 percent) stimulated activity also in the neighbouring countries such as Austria, whereas the highly-indebted southern euro area economies remained in stagnation.

At the same time, some withdrawal of fiscal and monetary expansion has moderated the pace of activity in the emerging economies in Asia. While the outlook is for continued firm growth in the region, decelerating import demand will weigh on prospects for the US economy, since private consumption in the USA is set to advance only gradually in the aftermath of the financial market crisis and with unemployment staying high.

For the euro area and the Central and Eastern European countries, leading indicators suggest GDP growth for the second half of 2010 still exceeding the long-term average. With the stimulus from currency depreciation fading, the pace of exports may decelerate in the months to come. Yet, higher capacity utilisation and improved corporate earnings should revive business fixed investment, rendering a relapse of the economy into recession increasingly unlikely.

Nevertheless, the upswing in the euro area is likely to stay moderate in 2011, on account of slower export growth on the one hand, and of the impact of the imminent fiscal consolidation on private demand on the other. This holds particularly for those euro area countries which struggle with low competitiveness and the after-effects of earlier real estate price bubbles. High public sector deficits in these countries and major macroeconomic imbalances in the euro area still pose considerable risks. In Germany and its neighbours, the recovery will therefore be stronger than in the southern part of the euro area.

For Austria, WIFO expects real GDP growth of 2.0 percent in 2010 and 1.9 percent in 2011. The recovery is primarily driven by exports of goods, expected to gain 12.0 percent and 7.3 percent, respectively, thereby returning to their level of 2008 towards the end of 2011. On the back of the favourable export outlook, domestic demand can be expected to pick up. Investment in machinery and equipment will stabilise, but construction activity is likely to remain sluggish over the entire forecast period. With the general business situation improving, private consumption will maintain its steady upward trend. While modest increases in real earnings and the planned fiscal consolidation measures will allow only small gains in real disposable income over both years, households should find scope for higher consumption by lowering their saving from 11.0 percent in 2009 to a projected 10.5 percent of disposable income by 2011.

Owing to the recovery and lower interest payments, the general government deficit for 2010, at a projected 4.1 percent of GDP, will turn out somewhat smaller than anticipated in spring. For 2011, the Federal government envisages consolidation measures totalling € 3.4 billion or 1.3 percent of GDP, 60 percent of which to be achieved through expenditure cuts. In addition, the Länder are expected to contribute € 0.8 billion to deficit reduction. In this way, the general government deficit should narrow to 3.5 percent of GDP in 2011. However, since specific measures have not yet been

disclosed, the projections are based on preliminary technical assumptions on the design of the consolidation strategy.

The projections see the number of persons in dependent active employment moving up by 0.8 percent and 0.6 percent, respectively, in 2010 and 2011¹. As labour supply will increase at the same time, the unemployment rate will edge down only marginally. Employment has risen primarily in services with a high share of part-time workers, whereas the fall in the number of manufacturing jobs has only recently come to a halt.

Employees' net real earnings per capita (deflated by the CPI) will decrease both in 2010 and 2011, by 0.9 percent and 0.2 percent, respectively. Apart from moderate wage settlements, this is due to a pick-up in inflation, driven in 2010 by rising oil prices. Underlying the projection for 2011 is the technical assumption that the increase in taxes and public charges with a view to fiscal consolidation will add 0.4 percentage points to headline inflation. Even though capacity utilisation and cost pressures will remain moderate, the rate of inflation (national CPI) will therefore ratchet up to 1.8 percent in 2010 and 2.1 percent in 2011.

Vienna, 24 September 2010

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¹ With the employment statistics collected by the Main Association of Austrian Social Security Institutions likely to be revised in 2011, figures for 2009 and 2010 may be revised ex post.

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). In the text, reference is made to "seasonally and working day adjusted changes".

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).

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/>).

WIFO Business Cycle Survey and WIFO Investment Survey

The WIFO business cycle survey is a monthly survey in which around 1,100 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.ikt.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 or persons carrying out alternative service with a valid employment contract. By deducting their number one arrives at the number of "persons in dependent active employment".

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Projections - September 2010

Main results

Percentage changes from previous year

		2006	2007	2008	2009	2010	2011
GDP							
Volume		+ 3.6	+ 3.7	+ 2.2	- 3.9	+ 2.0	+ 1.9
Value		+ 5.5	+ 5.9	+ 4.1	- 3.1	+ 3.0	+ 3.7
Manufacturing¹, volume		+ 8.2	+ 8.5	+ 3.5	- 14.0	+ 7.0	+ 5.5
Wholesale and retail trade, volume		+ 2.1	+ 2.0	+ 0.9	- 1.4	+ 1.8	+ 0.8
Private consumption expenditure, volume		+ 1.8	+ 0.7	+ 0.5	+ 1.3	+ 1.1	+ 0.8
Gross fixed investment, volume		+ 1.8	+ 3.9	+ 4.1	- 8.8	- 2.5	+ 2.4
Machinery and equipment		+ 1.8	+ 6.6	+ 7.5	- 14.5	- 2.0	+ 4.0
Construction		+ 0.7	+ 1.6	+ 1.6	- 6.0	- 3.0	+ 1.0
Exports of goods²							
Volume		+ 6.1	+ 9.0	+ 0.3	- 18.7	+ 12.0	+ 7.3
Value		+ 9.5	+ 10.5	+ 2.5	- 20.2	+ 14.8	+ 8.8
Imports of goods²							
Volume		+ 4.3	+ 7.6	+ 0.2	- 15.1	+ 8.6	+ 6.0
Value		+ 8.0	+ 9.6	+ 4.7	- 18.4	+ 13.3	+ 7.2
Current balance	€ bn	+ 7.26	+ 9.62	+ 9.24	+ 6.32	+ 7.64	+ 9.62
	as a percentage of GDP	+ 2.8	+ 3.5	+ 3.3	+ 2.3	+ 2.7	+ 3.3
Long-term interest rate³	percent	3.8	4.3	4.4	3.9	3.1	2.9
Consumer prices		+ 1.5	+ 2.2	+ 3.2	+ 0.5	+ 1.8	+ 2.1
Unemployment rate							
Eurostat definition ⁴	percent	4.8	4.4	3.8	4.8	4.4	4.3
National definition ⁵	percent	6.8	6.2	5.8	7.2	6.9	6.8
Persons in active dependent employment⁶		+ 1.7	+ 2.1	+ 2.4	- 1.4	+ 0.8	+ 0.6
General government financial balance							
according to Maastricht definition							
as a percentage of GDP		- 1.5	- 0.4	- 0.4	- 3.5	- 4.1	- 3.5

¹ Value added, including mining and quarrying. ² According to Statistics Austria. ³ 10-year central government bonds (benchmark). ⁴ According to Eurostat Labour Force Survey. ⁵ Public Employment Service Austria, percent of total labour force excluding self employed. ⁶ Excluding parental leave and military service.

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Key policy indicators

	2006	2007	2008	2009	2010	2011
Fiscal policy						
	As a percentage of GDP					
General government financial balance						
according to Maastricht definition	- 1.5	- 0.4	- 0.4	- 3.5	- 4.1	- 3.5
according to National accounts	- 1.6	- 0.5	- 0.5	- 3.5	- 4.1	- 3.5
General government primary balance	+ 1.2	+ 2.3	+ 2.1	- 0.7	- 1.4	- 0.7
Monetary policy						
	Percent					
3-month interest rate	3.1	4.3	4.6	1.2	0.8	1.0
Long-term interest rate ¹	3.8	4.3	4.4	3.9	3.1	2.9
	Percentage changes from previous year					
Effective exchange rate						
Nominal	+ 0.2	+ 1.1	+ 1.2	+ 0.9	- 0.7	+ 0.7
Real	- 0.5	+ 0.7	+ 0.6	+ 0.4	- 0.8	+ 0.9

¹ 10-year central government bonds (benchmark).

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Projections - September 2010

World economy

Percentage changes from previous year

	2006	2007	2008	2009	2010	2011
Real GDP						
World	+ 5.2	+ 5.2	+ 2.9	- 1.0	+ 4.0	+ 3.5
USA	+ 2.7	+ 1.9	± 0.0	- 2.6	+ 2.7	+ 2.0
Japan	+ 2.0	+ 2.4	- 1.2	- 5.2	+ 2.6	+ 1.4
EU 27	+ 3.2	+ 3.0	+ 0.5	- 4.2	+ 1.8	+ 1.8
Euro area 16	+ 3.0	+ 2.9	+ 0.5	- 4.1	+ 1.8	+ 1.7
Germany	+ 3.4	+ 2.7	+ 1.0	- 4.7	+ 3.2	+ 2.2
New member states ¹	+ 6.5	+ 6.0	+ 3.8	- 3.0	+ 1.5	+ 2.5
China	+ 11.6	+ 13.0	+ 9.7	+ 8.7	+ 10.0	+ 8.0
World trade , volume	+ 8.9	+ 7.1	+ 2.2	- 12.8	+ 18.8	+ 8.0
Market growth ²	+ 10.6	+ 7.1	+ 3.3	- 13.0	+ 11.5	+ 6.5
Primary commodity prices						
HWI Index, total	+ 19.7	+ 3.7	+ 22.4	- 29.2	+ 32	+ 1
Excluding energy	+ 22.0	+ 9.5	+ 15.6	- 22.7	+ 37	+ 1
Crude oil prices						
Brent, USD per barrel	65.1	72.5	97.0	61.5	76	80
Exchange rate						
USD per euro	1.256	1.371	1.471	1.393	1.30	1.35

¹ Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania.

² Real import growth of trading partners weighted by Austrian export shares.

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Private consumption, income and prices

	2006	2007	2008	2009	2010	2011
Percentage changes from previous year, volume						
Private consumption expenditure	+ 1.8	+ 0.7	+ 0.5	+ 1.3	+ 1.1	+ 0.8
Durables	+ 5.9	+ 2.6	+ 1.7	+ 5.2	- 1.0	- 0.3
Non-durables and services	+ 1.3	+ 0.5	+ 0.3	+ 1.0	+ 1.3	+ 0.9
Household disposable income	+ 3.0	+ 1.7	+ 1.8	+ 0.8	+ 0.8	+ 0.6
As a percentage of disposable income						
Household saving ratio¹	10.8	11.3	12.0	11.0	10.7	10.5
Household saving ratio²	10.2	11.0	11.8	10.5	10.3	10.1
Percentage changes from previous year						
Direct lending to domestic non-banks³	+ 4.5	+ 3.6	+ 7.4	- 1.3	+ 2.9	+ 4.1
Inflation rate						
National	1.5	2.2	3.2	0.5	1.8	2.1
Harmonised	1.7	2.2	3.2	0.4	1.8	2.1
Core inflation ⁴	1.3	1.9	2.4	1.5	1.3	1.6

¹ Including adjustment for the change in net equity of households in pension fund reserves.

² Excluding adjustment for the change in net equity of households in pension fund reserves.

³ End of period.

⁴ Excluding unprocessed food (meat, fish, fruits, vegetables) and energy items.

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Productivity

Percentage changes from previous year

	2006	2007	2008	2009	2010	2011
Total economy						
Real GDP	+ 3.6	+ 3.7	+ 2.2	- 3.9	+ 2.0	+ 1.9
Employment ¹	+ 1.5	+ 1.7	+ 2.2	- 0.8	+ 0.9	+ 0.7
Productivity (GDP per employment)	+ 2.1	+ 2.0	- 0.0	- 3.1	+ 1.1	+ 1.2
Manufacturing						
Production ²	+ 8.4	+ 8.7	+ 3.5	- 14.3	+ 7.0	+ 5.5
Employees ³	+ 0.2	+ 2.6	+ 1.7	- 6.0	- 1.2	+ 1.2
Productivity per hour	+ 8.0	+ 6.3	+ 2.3	- 5.4	+ 4.8	+ 4.2
Working hours per day per employee ⁴	+ 0.2	- 0.3	- 0.5	- 3.6	+ 3.3	- 0.0

¹ Dependent and self-employed according to National Accounts definition.

² Value added, volume.

³ According to Federation of Austrian Social Security Institutions.

⁴ According to 'Konjunkturerhebung' of Statistics Austria.

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Projections - September 2010

Earnings and international competitiveness

Percentage changes from previous year

	2006	2007	2008	2009	2010	2011
Wages and salaries per employee¹						
Gross earnings	+ 3.2	+ 3.1	+ 2.9	+ 1.5	+ 1.2	+ 2.2
Gross real earnings²	+ 1.7	+ 0.9	- 0.3	+ 1.0	- 0.6	+ 0.1
Net real earnings²	+ 1.5	+ 0.9	- 0.9	+ 2.7	- 0.9	- 0.2
<i>Total economy</i>						
Unit labour costs	+ 0.9	+ 0.9	+ 2.7	+ 4.8	+ 0.3	+ 1.0
<i>Manufacturing</i>						
Unit labour costs	- 3.4	- 2.3	+ 1.1	+ 13.5	- 6.2	- 1.7
Effective exchange rate - manufactures						
Nominal	+ 0.2	+ 1.2	+ 1.1	+ 0.7	- 0.7	+ 0.7
Real	- 0.4	+ 0.8	+ 0.6	+ 0.3	- 0.7	+ 0.9

¹ According to Federation of Austrian Social Security Institutions.

² Deflated by CPI.

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Labour market

Changes from previous year (1,000^s)

	2006	2007	2008	2009	2010	2011	
Demand for labour							
Persons in active employment ¹	+ 56.1	+ 68.6	+ 84.2	- 39.6	+ 33.4	+ 25.5	
Employees ²	+ 51.5	+ 65.5	+ 76.7	- 45.8	+ 27.4	+ 18.8	
<i>Percentage changes from previous year</i>	+ 1.7	+ 2.1	+ 2.4	- 1.4	+ 0.8	+ 0.6	
Nationals	+ 35.0	+ 43.6	+ 53.2	- 40.3	+ 17.4	+ 8.8	
Foreign workers	+ 16.5	+ 21.9	+ 23.5	- 5.6	+ 10.0	+ 10.0	
Self-employed ³	+ 4.6	+ 3.1	+ 7.5	+ 6.2	+ 6.0	+ 6.7	
Labour supply							
Population of working age (15 to 64 years)	+ 12.8	+ 15.5	+ 27.7	+ 17.3	+ 26.3	+ 30.6	
(15 to 59 years)	+ 47.3	+ 17.1	+ 17.6	+ 11.1	+ 12.3	+ 15.9	
Labour force ⁴	+ 42.6	+ 51.7	+ 74.2	+ 8.4	+ 23.1	+ 25.5	
Surplus of labour							
Registered unemployed ⁵	- 13.5	- 16.9	- 10.0	+ 48.1	- 10.3	± 0.0	
1,000 ^s	239.2	222.2	212.3	260.3	250.0	250.0	
Unemployed persons in training	1,000 ^s 57.5	52.7	50.5	64.1	73.7	69.0	
Unemployment rate							
Eurostat definition ⁶	percent	4.8	4.4	3.8	4.8	4.4	4.3
Percent of total labour force ⁵	percent	6.1	5.6	5.2	6.4	6.1	6.1
National definition ^{5,7}	percent	6.8	6.2	5.8	7.2	6.9	6.8
Employment rate							
Persons in active employment ^{1,8}	percent	63.9	64.9	66.1	65.2	65.5	65.6
Total employment (Eurostat) ^{6,8}	percent	70.2	71.4	72.1	71.6	71.7	71.9

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

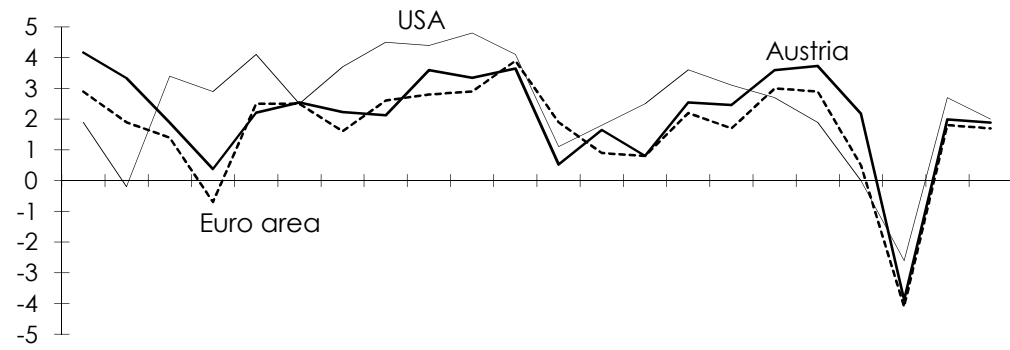
³ According to WIFO. ⁴ Persons in active employment plus unemployment.

⁵ According to Public Employment Service Austria ⁶ According to Eurostat Labour Force Survey.

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

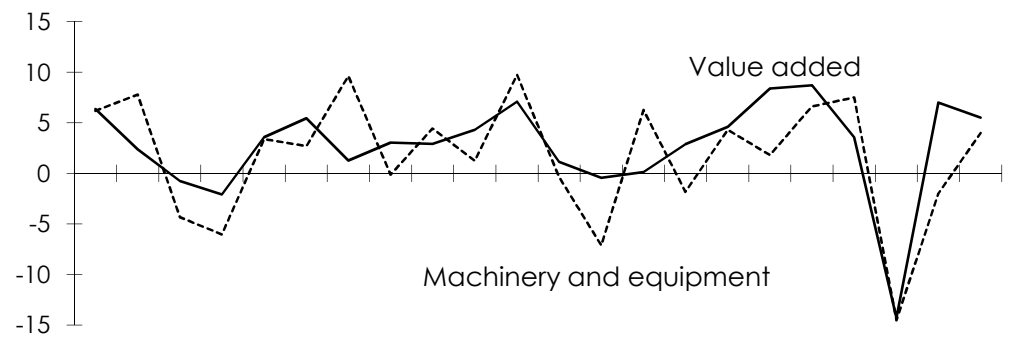
Growth of real GDP

Percent



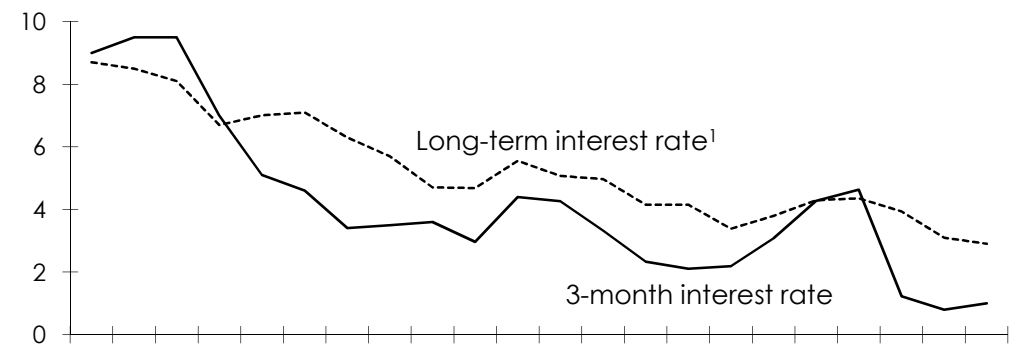
Manufacturing and investment

Percentage changes from previous year, volume



Short-term and long-term interest rates

Percent



Trade

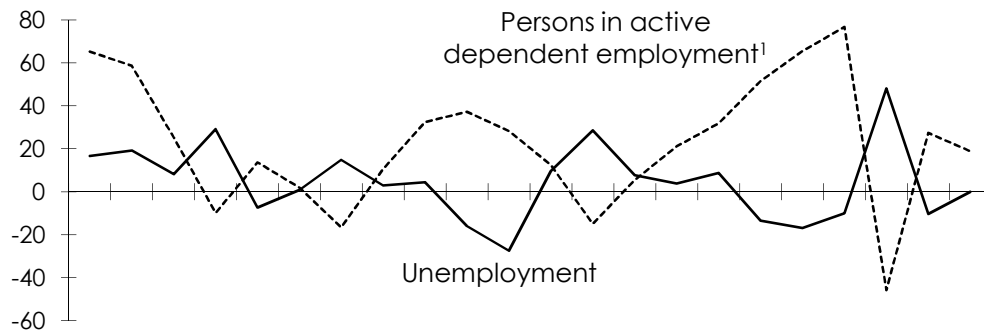
Percentage changes from previous year, volume



¹ 10-year central government bonds (benchmark).

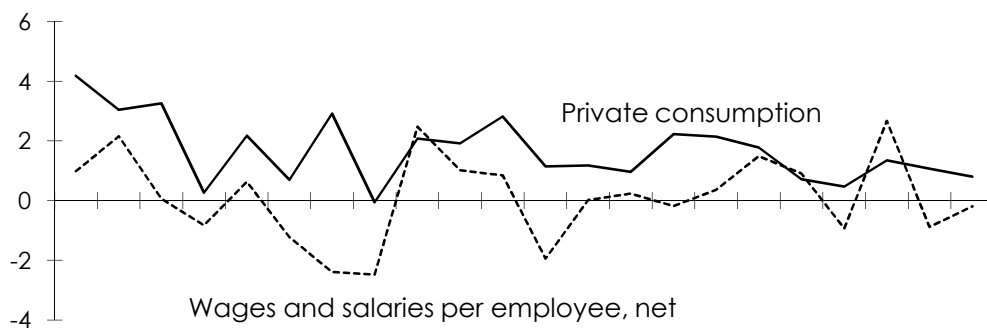
Employment and unemployment

1,000^s from previous year



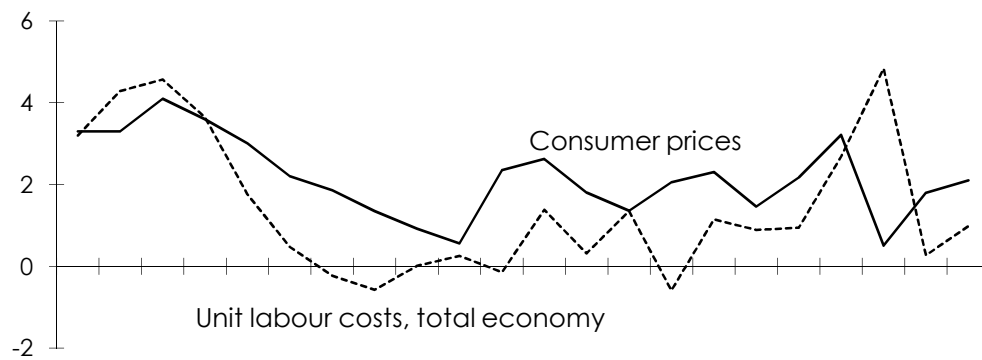
Consumption and income

Percentage changes from previous year, volume



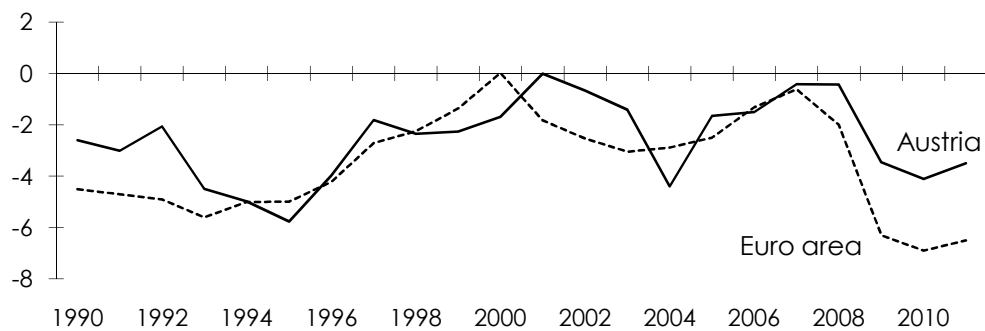
Inflation and unit labour costs

Percentage changes from previous year



General government financial balance

As a percentage of GDP



¹ Excluding parental leave, military service, and unemployed persons in training.