

■ HIGH ECONOMIC GROWTH IN 1998, BUT INCREASING RISKS IN 1999

ECONOMIC OUTLOOK FOR 1998 AND 1999

The Austrian economy is expected to grow in 1998 by 3.3 percent, the highest growth rate since 1991. A vigorous expansion of exports and investment outlays form the basis of this dynamic development. Economic activity is set to slow down in 1999, however, as a result of the turbulence on the global financial markets. At 2.8 percent, GDP growth in Austria will nonetheless continue to exceed the medium-term trend.

At present, the world economy is being shaken by a deep crisis on the financial markets. The currencies of a number of emerging market economies have suffered massive losses, while other countries are faced with the threat of such devaluations. The impact of the financial turmoil on economic activity and, more importantly, the deep pessimism spreading among investors resulted in a plunge in most stock markets from a level mostly supported by a speculative frenzy. The search for safe havens made German bonds appear very attractive and brought about a loss in the value of the dollar vis-à-vis the convoy of the euro currencies.

At the root of the financial crisis, which started in Asia, are political omissions, failed economic strategies, and speculative bubbles in the financial markets. The experience from earlier episodes of financial turmoil, especially after the stock market crash of October 1987, suggests that even a massive correction on the overheated equity markets need not have far-reaching consequences on economic activity. So far, the bear market in stocks in Europe and the USA did no more than offset the rise during the previous 12 months.

The stability of the world economy is also threatened by the recession in several emerging economies in Asia and Latin America as well as the deep crisis in Russia, which is spreading to neighboring countries. Another negative factor is Japan's persistent immobility in the political and economic sphere. These events darken the cyclical outlook for the economies of the USA and Europe as well.

Because of the relatively small importance of Russia's economy on the global plane and the moderate foreign trade links between Europe and the Asian re-

Main results

		1995	1996	1997	1998	1999
Percentage changes from previous year						
GDP						
Volume		+ 2.1	+ 1.6	+ 2.5	+ 3.3	+ 2.8
Value		+ 4.2	+ 3.7	+ 3.9	+ 4.6	+ 3.9
Manufacturing ¹⁾ , volume		+ 1.0	+ 1.2	+ 4.3	+ 6.5	+ 4.0
Private consumption, volume		+ 2.9	+ 2.4	+ 0.7	+ 1.8	+ 2.0
Gross fixed investment, volume		+ 1.9	+ 2.4	+ 3.6	+ 5.3	+ 3.6
Machinery and equipment		+ 3.1	+ 3.7	+ 4.2	+ 8.0	+ 5.5
Construction		+ 0.6	+ 2.8	+ 3.2	+ 3.0	+ 2.0
Exports of goods²⁾						
Volume		+12.1	+ 5.3	+15.3	+ 8.5	+ 7.0
Value		+13.2	+ 5.5	+16.8	+ 9.6	+ 8.1
Imports of goods²⁾						
Volume		+ 5.7	+ 6.1	+ 9.2	+ 8.3	+ 7.0
Value		+ 6.2	+ 6.7	+10.9	+ 8.3	+ 8.1
Trade balance ²⁾	(billion ATS)	-88.0	-100.6	-75.2	-72.3	-78.1
Current balance	(billion ATS)	-54.0	- 52.3	-56.1	-48.4	-47.5
As a percentage of GDP	(%)	- 2.3	- 2.2	- 2.2	- 1.8	- 1.7
Yield of long-term government bonds ³⁾	(%)	7.1	6.3	5.7	4.8	4.6
Consumer prices		+ 2.2	+ 1.9	+ 1.3	+ 1.0	+ 1.0
Unemployment rate						
Percent of total labor force ⁴⁾	(%)	3.9	4.3	4.4	4.5	4.4
Percent of dependent labor force ⁵⁾	(%)	6.6	7.0	7.1	7.2	7.0
Dependent employment ⁶⁾		+ 0.0	- 0.6	+ 0.4	+ 1.1	+ 0.9

¹⁾ Value added, including mining and quarrying. - ²⁾ According to Central Statistical Office. - ³⁾ 10-year central government bonds (benchmark). - ⁴⁾ According to Eurostat. - ⁵⁾ According to labor exchange statistics. - ⁶⁾ Excluding parental leave and military service.

gion, the impact on the European economies has been minimal so far. The strength of the European economies stands in stark contrast to the gloomy picture projected by the global economy. In most EU member countries, particularly the continental ones, the current economic upswing has spread to investment and other components of domestic demand. Thus, the economic recovery has become mostly self-sustained.

During the last several months, economic activity in the EU has also benefited from the de facto currency union and the concomitant exchange rate stability. The forces of integration within the single market, reinforced by the currency union, also help to stabilize economic activity. With an export rate of about 12 percent of the community GDP, the exposure of the euro zone to foreign trade is much lower than for the individual member countries.

The unavoidable uncertainties surrounding the diagnosis of other crisis centers and the impact of the financial turmoil on economic activity suggest not only a downward revision of the projections for 1999, but also constitute a risk factor for these forecasts.

Economic growth in Austria will reach 3.3 percent in 1998, the highest rate since 1991. Growth projections for 1999, however, have to be reduced in accordance with international forecasts, but at a rate of 2.8 percent GDP growth will remain above the medium-term trend. In the EU economies as well, growth will not accelerate as was expected in the summer months, but fall short of the rate recorded for 1998 (+2¾ percent), reaching 2½ percent.

The impact of the financial turbulence on Europe will probably not be severe because the reduction in demand from the emerging markets has been partially offset by positive effects: prices of raw materials and of energy are on the decline, and interest rates are falling. Inflation has come to a virtual standstill.

As a result of the tremors shaking the global economy, the countries participating in the Economic and Monetary Union have come to be viewed as a safe haven for investors. With inflation below 2 percent, the euro zone is a bastion of stability. Without a fixed schedule for achieving the single currency, recent events on the financial markets might have again forced a shift in exchange rate in Europe, with adverse effects on foreign trade.

Austria's economy is forecast to grow faster than the EU on average because its international competitive position has improved sharply during the last few years. In 1998, the economic recovery is mainly supported by buoyant merchandise exports and investment in machinery and equipment; in 1999, private consumption is forecast to contribute more to economic growth than in 1998. In the current year, the steep rise in the saving ratio is dampening consumer expenditures; though continuing in 1999, its depressing effect will be minimal.

For the first time since 1994, the unemployment rate will decline in the next year (from 4.5 to 4.4 percent). With the supply of labor rising exceptionally fast, the vigorous expansion in employment is not strong enough to lower unemployment in 1998.

As long as labor reserves, which have built up during several years of weak economic activity, continue to stream onto the labor market, it proves very difficult to cut unemployment. On the other hand, one third of the medium-term employment goal of the National Action Plan has already been attained in the first year of the five-year schedule.

WIFO's inflation forecast was sharply revised downwards mainly because of the plunge in prices of raw materials. In 1998 as well as in 1999, the inflation rate will reach a record low of 1 percent, and provide a solid basis for entering the Economic and Monetary Union at the beginning of 1999.

The general government deficit amounts to 2.2 percent in 1998 as well as in 1999. The draft budget of the federal government is consistent with the revised WIFO projections, particularly because the strong upturn in 1998 will boost receipts from some taxes with a certain lag. Fiscal policy will have to remain on an austerity course in order to come closer to the target of a more or less balanced budget as required by the Stability Pact.

Cut-off date: September 30, 1998.