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Exports Driving Activity

Economic Outlook for 2004 and 2005

The strengthening of global economic activity has initiated a recovery in Europe this year. Lively exports have led to a marked increase in manufacturing output. In Austria, as in the euro area as a whole, GDP is set to rise by 1.9 percent in volume in 2004. While world trade may lose momentum next year, growth in Europe should receive stronger support from domestic demand. However, the recent jump in oil prices constitutes a risk for the short-term outlook.

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The cyclical recovery has gained pace in the first half of 2004. On the back of a revival in global economic activity and with the rise in the euro exchange rate levelling off, exports increased markedly. On annual average, GDP in Austria, as well as in the euro area, is expected to gain 1.9 percent. In 2005, due to the effects of the tax reform, growth may accelerate to 2.5 percent, outpacing that for the euro area. Demand forces are expected to shift gradually from exports towards investment and consumption. The stimulus from activity abroad, notably from the USA, is set to slacken next year. The major cyclical risks derive from a possible further rise in oil prices and from leakages in the transmission of the export boom to investment and consumer demand.

Exports are the only support to the recovery, growing by 8¼ percent in volume this year. Austrian companies are largely benefiting from being major suppliers of German manufacturers, and their price competitiveness has increased significantly over the medium term, enabling them to seize new opportunities on world markets. Value added of the manufacturing sector is projected to gain 4½ percent in volume in 2004, more than twice the rate for the whole economy. Next year, export growth is expected to decelerate in line with the profile of world trade, a further cyclical recovery thus relying more on domestic demand.

Higher exports and rising capacity utilisation, together with improved corporate earnings, should set in motion an upswing in investment. While the latest WIFO investment survey points into that direction, such evidence is not yet confirmed by the official statistics for the first semester (abstracting from purchases of motor vehicles carried forward for tax reasons). Construction investment had provided major cyclical support in 2003, on account of public spending on civil engineering projects as well as pre-emptive implementation of projects in view of the abolition of the accelerated depreciation rule at the end of 2003. As a consequence, construction investment in 2004 is rising only slightly and less than anticipated.

Private consumption is growing by 1½ percent in 2004, considerably below its longer-term average. Real income gains are being squeezed by higher energy prices; yet, the private household saving ratio is not declining, despite the "forced consumption" induced by the high energy costs. The sustained increase in crude oil prices requires an upward correction of the inflation forecast: the rise in consumer prices will attain 2.1 percent in 2004 and edge down only slightly next year. The increase in energy prices is adding 0.3 percentage point to the inflation rate this year. While real earnings per employee are barely rising in 2004, the cuts in direct taxes in 2005 will boost real net incomes substantially. In addition, the expected marked increase in employment will raise disposable income. Private consumption growth should thus accelerate to 2.5 percent in 2005, thereby converging closely towards its medium-term trend.

Table 1: Main results

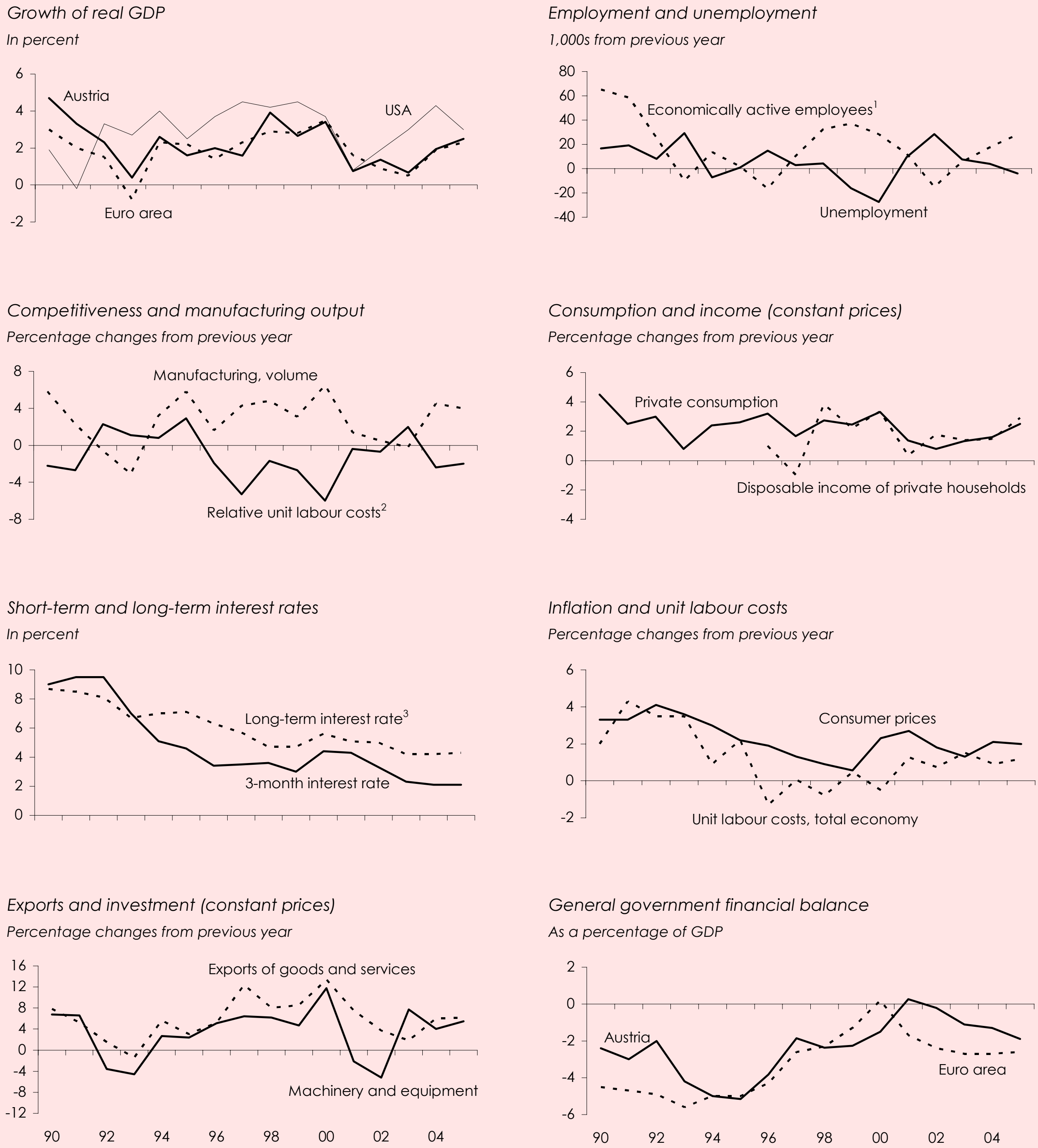
		2000	2001	2002	2003	2004	2005
		Percentage changes from previous year					
GDP							
Volume		+ 3.4	+ 0.8	+ 1.4	+ 0.7	+ 1.9	+ 2.5
Value		+ 4.9	+ 2.8	+ 2.7	+ 2.6	+ 3.3	+ 4.3
Manufacturing[1], volume		+ 6.4	+ 1.5	+ 0.5	− 0.2	+ 4.5	+ 4.0
Wholesale and retail trade, volume		+ 3.7	− 0.0	+ 1.2	+ 1.3	+ 1.3	+ 2.5
Private consumption expenditure, volume		+ 3.3	+ 1.4	+ 0.8	+ 1.3	+ 1.6	+ 2.5
Gross fixed investment, volume		+ 6.2	− 2.3	− 2.8	+ 5.3	+ 2.2	+ 3.5
Machinery and equipment[2]		+ 11.8	− 2.1	− 5.2	+ 7.7	+ 4.0	+ 5.5
Construction		+ 1.9	− 2.5	− 0.7	+ 3.3	+ 0.7	+ 1.7
Exports of goods[3]							
Volume		+ 13.1	+ 7.5	+ 5.2	+ 2.7	+ 8.3	+ 6.8
Value		+ 15.6	+ 6.5	+ 4.2	+ 1.9	+ 9.5	+ 7.5
Imports of goods[3]							
Volume		+ 10.9	+ 5.7	+ 0.8	+ 6.3	+ 5.3	+ 7.1
Value		+ 14.7	+ 5.0	− 2.0	+ 5.0	+ 7.5	+ 7.8
Current balance	billion €	− 5.36	− 4.13	+ 0.36	− 2.04	− 1.62	− 1.92
As a percentage of GDP		− 2.6	− 1.9	+ 0.2	− 0.9	− 0.7	− 0.8
Long-term interest rate[4]	in percent	5.6	5.1	5.0	4.2	4.2	4.3
Consumer prices		+ 2.3	+ 2.7	+ 1.8	+ 1.3	+ 2.1	+ 2.0
Unemployment rate							
Eurostat definition[5]	in percent	3.7	3.6	4.3	4.1	4.2	4.1
National definition[6]	in percent	5.8	6.1	6.9	7.0	7.1	6.9
Economically active emplyees[7]		+ 0.9	+ 0.4	− 0.5	+ 0.2	+ 0.6	+ 0.9
General government financial balance according to Maastricht definition							
As a percentage of GDP		− 1.5	+ 0.3	− 0.2	− 1.1	− 1.3	− 1.9

Source: WIFO Economic Outlook. – [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 Labour Force Survey. – [6] According to Labour Market Service, as a percentage of total labour force excluding self employed. – [7] Excluding parental leave, military service, and unemployed persons in training.

Employment has started reacting to the recovery of business activity. The number of economically active employees is projected to go up by 17,500 in 2004 and 28,000 in 2005. Increasingly, also new full-time jobs are being created. The number of people unemployed will edge up by a further 4,000 (to a total of 244,000) in 2004 and should fall by the same amount in 2005. Labour supply will continue to expand strongly in 2005, the inflow of foreign workers to the labour market staying lively.

The general government deficit in the Maastricht definition, projected at 1.3 percent of GDP for the current year, will turn out significantly higher than anticipated. The investment accrual tax premium ("Investitionszuwachsprämie") will lead to massive shortfalls in income and corporate tax revenues. Losses of receipts from VAT are likely to diminish in the second half of this year, given the likely solid increase in consumption. The upward correction of projected GDP growth, being confined to the export component, is hardly affecting expected government revenues. In 2005, the general government deficit will be slightly below 2 percent of GDP, if the sizeable cut in income and corporate taxes can be partly offset by revenue-raising one-off measures.

Figure 1: Indicators of economic performance



Source: WIFO Economic Outlook. – [1] Excluding parental leave, military service, and unemployed persons in training. – [2] Manufacturing; in a common currency vis-à-vis trading partners. – [3] 10-year central government bonds (benchmark).

Expansion of global economic activity losing steam

Business activity in the USA and Asia has by now gained such momentum as has been regularly observed in previous cyclical episodes. This is driving the world economy forward. World trade growth is set to reach 8½ percent this year and abate only gradually in 2005. The impulse will extend also to those export-oriented economies where overall activity has been held back in recent years by the persistent stagnation of domestic demand (Japan, Germany).

The US economy will expand by over 4 percent this year. The dynamism of investment bodes well for the sustainability of the upswing. Private consumer spending in recent months, however, has not lived up to the somewhat exaggerated expectations. The waning stimulus from stock and real estate markets is steering consumption to a somewhat steadier pace. In 2005, GDP growth may moderate to a rate of 3 percent. The effects of the recent massive fiscal expansion will taper off, and pressure for fiscal consolidation is likely to become strong after the presidential elections. The measures of retrenchment that will be taken in this regard will have a restrictive effect on activity in the short term.

Despite buoyant global activity, sentiment on financial markets remains subdued, as the sustained high oil prices add to uncertainty. Stock markets therefore provide currently no positive incentives to economic growth. The jump in real estate prices over the last years is fuelling private consumption in the USA as well as in the UK and Scandinavia. However, these high house prices now constitute a risk for the further cyclical development.

Table 2: World economy

		2000	2001	2002	2003	2004	2005
		Percentage changes from previous year					
Real GDP							
Total OECD		+ 3.9	+ 1.0	+ 1.8	+ 2.1	+ 3.3	+ 2.7
USA		+ 3.7	+ 0.8	+ 1.9	+ 3.0	+ 4.3	+ 3.0
Japan		+ 2.8	+ 0.4	– 0.3	+ 2.5	+ 3.5	+ 2.8
EU 25		+ 3.6	+ 1.7	+ 1.1	+ 0.9	+ 2.3	+ 2.5
EU 15		+ 3.6	+ 1.7	+ 1.0	+ 0.8	+ 2.2	+ 2.4
Euro area		+ 3.5	+ 1.6	+ 0.9	+ 0.5	+ 1.9	+ 2.3
Germany		+ 2.9	+ 0.8	+ 0.2	– 0.1	+ 1.7	+ 1.8
New member states[1]		+ 4.1	+ 2.5	+ 2.4	+ 3.6	+ 4.0	+ 4.3
China		+ 8.0	+ 7.3	+ 8.0	+ 9.1	+ 9.0	+ 8.0
World trade, volume		+12.4	+ 0.3	+ 3.3	+ 4.1	+ 8.5	+ 7.0
Market growth[2]		+12.0	+ 2.4	+ 1.8	+ 4.4	+ 7.0	+ 6.5
Primary commodity prices							
HWWA index, total		+51	– 8	– 5	– 4	+16	+ 7
Excluding energy		+19	– 3	– 6	– 6	+12	+10
Crude oil prices							
Average import price (cif) for OECD countries	$ per barrel	28.0	23.6	24.1	28.4	36.0	38.0
Exchange rate							
$ per euro		0.924	0.896	0.945	1.13	1.23	1.23

Source: WIFO Economic Outlook. – [1] Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia. – [2] Real import growth of trading partners weighted by Austrian export shares.

Pulled by strong demand from China and the USA, the Japanese economy is gaining steam. Real GDP is expected to move up by 3½ percent this year. The risks of an early collapse of the recovery appear contained, even if business data are at times rather volatile; the boom in exports is being transmitted to investment and consumption. In 2005, growth in Japan may abate to below 3 percent. Much stronger is the expansion in China, India and the "tiger states". As a market of 1.3 billion consumers, China today enjoys high attractiveness for international investors. GDP is growing by 9 percent this year, a significant deceleration not being in sight despite the efforts made in this regard by the Chinese government.

High oil prices being a risk factor

The high momentum of world economic growth, supply uncertainties in some oil-producing countries, and speculative behaviour have made for a strong upward drift in commodity and energy prices. World market prices of raw materials on a dollar basis are jumping by around one-quarter this year. Oil prices on annual average 2004 stand at $ 36 per barrel, up by about one-third from last year. While this is likely to dampen economic growth in the industrialised economies, it should not put an end to the business cycle upswing. The pass-through of the oil price hike onto manufactures prices and overall inflation has been limited so far, as the use of energy inputs has become more efficient in the last decades.

According to model simulations by the OECD, an increase in oil prices by $ 10 per barrel reduces GDP growth in the industrialised countries by 0.4 percentage point. In the EU this effect is estimated at 0.5 percentage point, whereas in the USA and Japan it is somewhat smaller, due to higher domestic oil production in the former case and lower energy intensity in the latter. The UK National Institute of Economic and Social Research (NIESR) points out that the impact of an oil price increase also depends on policy reaction. Higher oil prices imply shifts in the terms-of-trade (i.e., the relation between export and import prices) and a redistribution of income from oil importing to oil exporting countries. The earlier the oil producers spend their additional revenues on higher imports, the smaller will turn out the negative effects for the industrial economies.

The oil price currently includes a high risk premium that derives mainly from possible supply disruptions in the Middle East, Nigeria, Venezuela and Russia. The forecast for oil prices therefore hinges to a high degree on political factors and is subject to a wide margin of uncertainty. Moreover, speculation is playing an increasing role. The WIFO projections are based upon oil prices averaging $ 38 in 2005, as a technical assumption. A stronger increase is bound to dampen economic growth along the lines of the model calculations cited above.

Interest rates remaining low

In view of the strength of economic activity, the US central bank maintained its stance of gentle increases in interest rates. In September, for the third time since the end of June, it raised the key rate by 25 basis points, to currently 1.75 percent. The Fed confirmed its intention to continue with moderate monetary restriction in order to pre-empt inflationary danger. Such risks do not appear particularly acute as economic growth looks set to decelerate.

The European Central Bank, pursuing a "steady hand" policy, has left the basic interest rate unchanged since June 2003. The Bank is likely to tread carefully also next year and may keep interest rates low. An analysis carried out by WIFO shows that monetary policy in the USA usually follows the Taylor rule (inflation and growth target) without delay, whereas the ECB typically reacts with a lag of one year. This finding suggests that euro area interest rates may remain stable next year. Inflationary danger appears rather remote in the euro area, against the background of a moderate cyclical recovery and the persistently high unemployment. A precondition is, however, that oil prices do not rise more strongly than projected. A further argument for continued low interest rates in the euro area is the fact that the growth of money supply has converged in recent months towards the reference value defined by the ECB. The excess liquidity generated by the low money market rates will likely be absorbed gradually.

In spite of the increase in policy-controlled interest rates in the USA, long-term rates still follow a slow downward trend. They hover within a narrow band around 4 percent. The funds in need of placement from oil exporting countries as a consequence of the oil price jump may contribute towards stability of long-term interest rates. The WIFO projections assume that long-term rates will rise only marginally next year.

Shift from exports towards domestic demand in the euro area

The European economy owes its crucial cyclical stimulus to the lively demand from abroad. In the first semester, merchandise exports rose faster than expected. The forecast for GDP growth is therefore revised upwards from 1.7 percent to 1.9 percent. For 2005, growth is projected at 2.3 percent, assuming a steady, but moderate upward trend. The export boom should translate via higher incomes into higher investment and consumer spending. The longer exports remain buoyant, the more likely will rising capacity utilisation give incentives to investment. The additional income generated by investment should subsequently lead to a pick-up in private consumption. This process could, however, be held back by the rise in oil prices and uncertainty related to the reforms in social welfare systems.

The driving cyclical forces should shift from exports towards domestic demand in 2005. This would shield Europe from the negative repercussions of a slackening of activity in the USA and Japan. Yet, the uncertainties surrounding the transmission of stimulus from the export boom to investment and consumption plead in favour of caution with regard to the growth projection. Risks of higher inflation on account of sluggish growth of potential output are currently of only minor concern in Europe, given the considerable labour supply overhang.

Export boom in Germany

The German export industry is benefiting from the global economic boom with a certain time lag. In the first six months, exports picked up strongly, raising overall GDP growth beyond expectations. The good opportunities on foreign markets suggest that GDP growth in Germany will accelerate to an annual rate of 1¾ percent in 2004 and 2005. Retarding elements are sluggish construction investment and private consumption. With many households stepping up precautionary saving, retail sales in Germany fare markedly below the EU average. Contrary to most other EU countries, the private household saving ratio is heading up. The motivation for higher spending is undermined by the critical labour market situation and the uncertainty related to the reform of social welfare systems. A sustained improvement in labour market conditions as well as in public finances in Germany would, on the other hand, require a stronger rebound in economic activity.

The assessment of the short-term outlook for Germany is controversial, as the projections by the research institutes are widely apart. The Kiel Institute for World Economics sees GDP growth in 2005 at a modest 1.2 percent, since the global boom would have passed its peak, the positive working-days effect would be reversed and potential growth would increase by only 1 percent.

According to the ifo Institute's business survey, firms see current conditions broadly unchanged, but have revised down their expectations for the next six months. The indicator by the ZEW has been declining for the last couple of months, although this may reflect the frustration of financial managers in the sample about the sluggishness on stock markets.

Recovery in Austria making further progress

Activity in Austria has clearly gained momentum since spring. Real GDP rose significantly in the second quarter, by 0.9 percent on a seasonally-adjusted basis after 0.4 percent in the previous period, exceeding the year-earlier level by 1.9 percent, up from 0.8 percent in the first quarter. In 2004, the Austrian economy is likely to grow at the same pace as the euro area average, by 1.9 percent. Lively export orders make for a solid expansion of manufacturing production (+4½ percent). However, the increase in construction output falls short of expectations, such that the projection for overall GDP in 2004 is taken up by only a limited amount, from 1.7 to 1.9 percent.

Compared with previous cyclical episodes, the recovery remains moderate, held back by high oil prices and cautious spending behaviour of consumers. This is confirmed by the results from the regular WIFO business survey, which point to a steady upward trend rather than a vigorous upswing. For next year, Austria may expect a rate of economic growth of 2½ percent. It will surpass that of the euro area as a whole, on account of the effects of the tax reform. While growth in 2004 is export-led, the driving forces should shift from foreign towards domestic demand in 2005.

The present projections are subject to two major risks: first, it is assumed that the recovery will not be choked off by oil prices climbing to new highs; second, it is further assumed that, like in the past, the export boom will be transmitted to domestic investment and private consumption. Since this process usually involves a certain time lag, it is not yet discernible in recent statistical data. It is conceivable that firms decide to build up their financial reserves or invest in countries where costs are lower or sales opportunities better, or that private households shy away from spending on major items due to higher social risks.

Strong dynamics of exports

Because of the rising euro exchange rate, exports took somewhat longer than usual to respond to the international business cycle upswing. By now, however, the export boom has massively set in. In the first half of the year, Austrian firms sold 9.7 percent more goods abroad, in real terms, than one year ago. Exports to third countries, notably the USA and south-eastern Europe, moved up substantially, but also those to the euro area picked up. Deliveries of machinery and vehicles expanded above average. Austria is benefiting from close supply ties with the German export-oriented industries, which in turn are driven forward by the world-wide boom. Import prices are rising markedly on the back of the broad-based price increases for internationally traded commodities, leading to a deterioration in the terms-of-trade by around 1 percent in 2004. The current account deficit may nevertheless shrink slightly this year, from 0.9 percent to 0.7 percent of GDP. Unit labour costs in manufacturing are edging down in 2004 and, unlike in 2003, Austria's competitive position as measured by relative unit labour costs in a common currency is improving. The surplus on cross-border tourism services is rising slightly: foreign earnings will increase by an inflation-adjusted 1½ percent, boosted mainly by lively demand for visits to the larger cities.

Table 3: Productivity

	2000	2001	2002	2003	2004	2005
	Percentage changes from previous year					
Total economy						
Real GDP	+ 3.4	+ 0.8	+ 1.4	+ 0.7	+ 1.9	+ 2.5
Employment[1]	+ 0.8	+ 0.6	− 0.2	− 0.1	+ 0.5	+ 0.9
Full-time equivalent	+ 1.0	+ 0.6	− 0.0	+ 0.1	+ 0.3	+ 0.7
Productivity (GDP per employment)	+ 2.6	+ 0.1	+ 1.6	+ 0.8	+ 1.4	+ 1.6
Full-time equivalent	+ 2.4	+ 0.1	+ 1.4	+ 0.5	+ 1.7	+ 1.8
Manufacturing						
Production[2]	+ 6.5	+ 1.4	+ 0.5	− 0.2	+ 4.5	+ 4.0
Employees[3]	+ 0.0	+ 0.2	− 2.5	− 1.7	− 0.5	± 0.0
Productivity per hour	+ 6.6	+ 1.6	+ 3.6	+ 1.3	+ 4.8	+ 3.8
Working hours per day per employee[4]	− 0.1	− 0.4	− 0.5	+ 0.2	+ 0.2	+ 0.2

Source: WIFO Economic Outlook. – [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.

Austrian exports of goods are gaining 8¼ percent in volume this year. Firms benefit in particular from the pick-up in the German export industry. In spite of a marked increase in import prices, the current account is improving in 2004. As domestic demand picks up in 2005, imports will rise somewhat faster in real terms than exports.

World trade is set to lose momentum in 2005. Growth of Austrian exports may therefore moderate from 8.3 percent in real terms to 6.8 percent. Under the impact of strengthening domestic demand, the current account deficit is projected to widen from € 1.6 billion to € 1.9 billion.

Rebound in investment likely

Higher exports usually lead, with a certain time lag, to a pick-up in investment, induced by rising profits and higher capacity utilisation. In past periods of strong cyclical rebound, investment expanded at double-digit rates. In the first half of 2004, real business spending on machinery and equipment barely rose on a seasonally-adjusted basis, exceeding the year-earlier level by a mere 3 percent. It should be noted, however, that for tax reasons investment in vehicles, but also in machinery, had been carried forward into 2003.

The reaction of investment to the export boom will largely determine the further profile of the upswing. The results from the WIFO investment survey point to an increase. The WIFO projections assume that investment in machinery and equipment will rise by 4 percent this year and 5½ percent in 2005. The distribution of the overall increase between the two calendar years is difficult to predict, however, since further carry-forward effects should be expected before the investment premium is due to expire at the end of 2004 (originally, the premium was to be phased out at the end of 2003). The additional net earnings from exports, the investment premium and the cuts in income and corporate taxation should all give incentives to higher spending on business capital. Whether capacity utilisation will be sufficiently high in order to stimulate investment will largely depend on the duration of the export boom.

The raising of the ceilings for public guarantees has allowed a higher number of construction projects to be implemented, despite the strain in government finances. Because of the stronger flow of orders for public infrastructure and in view of the imminent expiration of the accelerated depreciation tax rule, construction investment projects were carried forward into 2003 to a larger extent than anticipated. In the first semester 2004, construction investment was much weaker than assumed, stagnating in real terms. Residential construction and civil engineering posted small gains in volume, while other building activity (creation of new office space) receded. Since part of existing office space is vacant, new construction was reduced.

On average for 2003 and 2004, construction output gained 2 percent p.a. While in 2003, the expansion contributed significantly towards overall cyclical stabilisation, the impact is markedly smaller in 2004. The projection for 2004 is revised down to 0.7 percent, for 2005 it is for an increase of 1.7 percent. The fall in the number of building permits for subsidised dwellings points to a slackening in new-home construction. Industrial and commercial building, for its part, should receive stimulus from the more favourable investment climate. Order levels for road and railroad construction remain satisfactory. The fall in construction employment is losing pace.

Tax cuts bolstering private consumption in 2005

Against the background of stagnating real incomes and increased private financial provisions for retirement, private households remained cautious in their spending behaviour. Retail sales edged up by only ½ percent in volume in the first half of this year. New passenger car registrations and demand for services fared better. On annual average 2004, private consumption is projected to gain 1.6 percent. The saving ratio is not heading down, despite sluggish income growth and the price-induced "imposed" consumption of more energy.

Table 4: Private consumption, earnings and prices

	2000	2001	2002	2003	2004	2005
	Percentage changes from previous year, volume					
Private consumption expenditure	+3.3	+1.4	+0.8	+1.3	+1.6	+2.5
Durables	+3.9	+1.8	+3.6	+0.8	+3.5	+5.5
Non-durables and services	+3.2	+1.3	+0.4	+1.4	+1.3	+2.0
Household disposable income	+3.3	+0.4	+1.8	+1.4	+1.5	+2.9
Household saving ratio						
As a percentage of disposable income	8.4	7.5	8.2	8.4	8.4	8.9
	Percentage changes from previous year					
Direct lending to domestic non-banks[1]	+6.7	+3.5	+1.2	+1.6	+4.6	+5.4
	Percent					
Inflation rate						
National	2.3	2.7	1.8	1.3	2.1	2.0
Harmonised	2.0	2.3	1.7	1.3	2.1	1.9
Core inflation[2]	0.9	2.3	2.0	1.3	1.7	1.6

Source: WIFO Economic Outlook. – [1] End of period. – [2] Excluding unprocessed food (meat, fish, fruits, vegetables) and energy items.

For the cyclical profile next year it will be crucial, to what extent private households' propensity to consume will increase. The cuts in direct taxes will contribute importantly towards raising purchasing power.

The wage and income tax cuts and the expected gains in employment will boost net disposable income of private households substantially in 2005. Thus, employees' per-capita income should rise by 2 percent in real terms after tax, the number of new jobs by nearly 1 percent. Private consumption may grow by 2½ percent. In a year where tax cuts take effect the saving ratio usually goes up, since part of the net income gains is spent only with a time lag. Demand for durable consumer goods will increase markedly in 2005, although the major part of the additional demand will be covered by imports.

Higher oil prices driving up inflation

Price developments are shaped by oil prices, which are rising to ever new highs. Nevertheless, the increase is much less pronounced than with the oil price shocks of the 1970s. At that time, oil prices tripled, whereas currently they are up by one-third from last year.

The price of Brent came to exceed $ 45 per barrel during the last weeks of September. Petrol and diesel were 15 percent more expensive in August than one year ago. The rate of inflation moved up to 2.4 percent, of which 0.5 percentage point is accounted for by the energy price hike. However, the higher energy prices have not yet been fully passed on to consumer prices. Price increases for gas and electricity as well as for manufactures of high energy content are still in the pipeline. Along with the oil price hike, quotations of other raw materials and semi-manufactures (e.g., steel) drifted up with the global economic boom. The wholesale price index, which also includes these items, was 6.3 percent up from last year in August.

Headline inflation has more than doubled since the beginning of the year, from 1.1 percent in January to 2.4 percent in August. Major price cuts were recorded only for computers and digital cameras. Against this background, the inflation projection for 2004 is being corrected upwards from 1.9 to 2.1 percent. In 2005, the rate of inflation is unlikely to moderate significantly, as the impact of higher oil prices will be reflected with a lag in the consumer price index, even if the direct effects will largely wear off.

Table 5: Earnings and international competitiveness

	2000	2001	2002	2003	2004	2005
	Percentage changes from previous year					
Gross earnings per employee[1]	+2.5	+1.4	+2.2	+2.3	+2.4	+2.8
Full-time equivalent	+2.6	+1.4	+2.1	+2.5	+2.9	+3.2
Gross real earnings per employee[1]	+1.0	−0.8	+1.0	+0.5	+0.3	+0.8
Net real earnings per employee[1]	+1.6	−1.1	+0.8	+0.2	+0.6	+2.0
Net wages and salaries	+4.5	+2.1	+2.5	+2.7	+2.6	+4.2
Total economy						
Unit labour costs	−0.5	+1.3	+0.7	+1.5	+0.9	+1.2
Manufacturing						
Unit labour costs	−5.0	+1.6	−0.7	+0.3	−2.5	−1.3
Relative unit labour costs[2]						
Vis-à-vis trading partners	−6.0	−0.4	−0.7	+2.0	−2.4	−2.0
Vis-à-vis Germany	−2.3	−0.1	−0.5	+0.2	−2.9	−1.8
Effective exchange rate, manufactures						
Nominal	−2.7	+0.9	+1.3	+3.7	+0.8	+0.2
Real	−3.3	+0.5	+0.8	+2.9	+1.0	−0.7

Source: WIFO Economic Outlook. – [1] Employees according to National Accounts definition. – [2] In a common currency; minus sign indicates improvement of competitiveness.

Contractual wages in 2004 are 2 percent above the level of last year. The increase in effective earnings per capita is relatively higher, since average working hours rise in the cyclical upturn. The acceleration of inflation makes for quasi-stagnation in real gross earnings this year. In 2005, real net incomes per employee will rise by 2 percent due to the tax reform, reinforcing the purchasing power base for an increase in private consumption.

Rising employment

Demand for new labour reacted relatively early to the pick-up in activity. In 2004, the number of people in active dependent employment is growing by 17,500 or 0.6 percent. Although the increase is concentrated in sectors where part-time work is frequent (trade, tourism, health services, business services), job losses are also diminishing in manufacturing and construction. Moreover, not only female, but also male employment is rising. Nevertheless, the employment figures are statistically biased upwards by including people in part-time retirement ("Altersteilzeit"): in this arrangement, if the working period is lumped to full-time and front-loaded, people are no longer in active employment in the rest of the period.

The improved economic situation is leading to an increase in employment that is not confined to part-time jobs. Still, the number of unemployed may change little, since labour supply is rising at the same time. The full impact of the cyclical upturn will be felt on the labour market only with a rebound in private consumption and stronger job creation in the service sector.

Unemployment appears to have reached its cyclical peak last summer, when it exceeded the year-earlier level only by a small margin. On annual average, the rate of unemployment, as defined by Eurostat, is projected at 4.2 percent, after 4.1 percent in 2003[1].

Table 6: Labour market

		2000	2001	2002	2003	2004	2005
		Changes from previous year, in 1,000					
Demand for labour							
Economically active employment[1]		+ 30.1	+ 13.9	– 11.6	+ 8.5	+ 20.7	+ 31.5
Employees[2]		+ 28.2	+ 12.4	– 15.0	+ 5.5	+ 17.5	+ 28.1
Percentage changes from previous year		*+ 0.9*	*+ 0.4*	*– 0.5*	*+ 0.2*	*+ 0.6*	*+ 0.9*
Nationals		+ 14.8	+ 3.0	– 20.1	– 10.4	+ 4.5	+ 7.0
Foreign workers		+ 13.4	+ 9.5	+ 5.1	+ 15.9	+ 13.0	+ 21.1
Self-employed[3]		+ 1.9	+ 1.5	+ 3.4	+ 3.0	+ 3.2	+ 3.4
Labour supply							
Population of working age	15 to 64 years	+ 27.0	+ 27.5	+ 27.0	+ 29.1	+ 11.7	– 4.0
	15 to 59 years	– 16.5	– 13.8	– 1.2	+ 12.3	+ 14.3	+ 26.3
Labour force[4]		+ 2.7	+ 23.5	+ 17.0	+ 16.1	+ 24.6	+ 27.5
Surplus of labour							
Registered unemployed[5]		– 27.4	+ 9.6	+ 28.5	+ 7.7	+ 3.9	– 4.0
In 1,000		194.3	203.9	232.4	240.1	244.0	240.0
		Percent					
Unemployment rate							
Eurostat definition[6]		3.7	3.6	4.2	4.1	4.2	4.2
As a percentage of total labour force[5]		5.3	5.5	6.2	6.3	6.4	6.2
National definition[5,7]		5.8	6.1	6.9	7.0	7.1	6.9
Employment rate							
Economically active employment[1,8]		63.3	63.3	62.8	62.6	62.8	63.4
Total employment[6,8]		68.5	68.5	69.2	69.2	69.4	69.6

Source: WIFO Economic Outlook. – [1] Excluding parental leave, military service, and unemployed persons in training. – [2] According to Federation of Austrian Social Security Institutions. – [3] According to WIFO. – [4] Economically active employment plus unemployment. – [5] According to Labour Market Service. – [6] According to Eurostat Labour Force Survey. – [7] As a percentage of total labour force, without self-employed. – [8] As a percentage of population of working age (15 to 64 years).

In 2005, stronger growth will lead to an increase in employment by a projected 28,000 or 0.9 percent. The bulk of the additional jobs will go to foreign workers. The number of unemployed, as defined by the Labour Market Service, may edge down by 4,000 to a level of 240,000, pushing the rate of unemployment below 7 percent. The number of registered unemployed is difficult to predict, since it may be influenced strongly by labour market policy measures such as training courses, granting of advance retirement payments or transitory unemployment benefits for older workers.

Substantial losses in tax revenues

The general government balance, in the Maastricht definition, will exhibit a deficit amounting to 1.3 percent of GDP this year, as compared with a deficit target ratio of 0.7 percent. The slippage is mainly due to lower-than-budgeted tax revenues. In particular the shortfall in income and corporate tax revenues on account of the investment premium will be roughly € 700 million, against the € 150 million included in the budget. Firms have to some extent carried forward investment in motor vehicles, as confirmed by the high number of new registrations of trucks. That was the very intention of the counter-cyclical measure. However, the largest part of the investment in vehicles and machinery was covered by imports, with only a limited impact on GDP. Newly established companies may claim 10 percent of their total investment in vehicles and machinery as investment premium.

[1] Eurostat has revised down the unemployment rate for the last three years by some 0.3 percentage point. The imminent data revision in the context of the EU Labour Force Survey will raise the unemployment rate and lower the employment rate.

Revenues from VAT also remained below expectations in the first half of 2004, with the shortfall estimated at € 600 million. The projections imply, however, that for the whole year the shortfall may diminish, since private consumption should pick up strongly in the second half from the modest gain registered in the previous period. The latter assumption is warranted also by the base effect, since consumption in 2003 was buoyant in the first, but lacklustre in the second half.

2004 will see substantial shortfalls in tax revenues, which will drive up the government deficit in the Maastricht definition to 1.3 percent of GDP. As a consequence of the tax reform, the general government deficit in 2005 will rise to close to 2 percent of GDP.

Higher than anticipated are revenues from mineral oil tax. The reason is not the oil price increase, since the tax base for the mineral oil tax is the quantity of fuel consumption. The main reason should rather be seen in demand from neighbouring countries: when prices are particularly high, there is a greater incentive to exploit cross-country differences. Because of a lower tax burden, fuel prices are significantly lower in Austria than in Germany and Italy.

The cyclical recovery this year provides only little relief for government finances, since it is based mainly on higher exports, which are exempt from VAT and, moreover, have limited direct effects on employment. The upward revision to the projection has therefore only a minor impact on public revenues, and the amount of transfers to the unemployed remains unchanged.

Table 7: Key policy indicators

	2000	2001	2002	2003	2004	2005
	As a percentage of GDP					
Fiscal policy						
General government financial balance						
According to Maastricht definition	−1.5	+0.3	−0.2	−1.1	−1.3	−1.9
According to National Accounts	−1.7	+0.1	−0.4	−1.3	−1.4	−2.0
General government primary balance	+2.2	+3.8	+3.1	+1.9	+1.8	+1.2
	Percent					
Monetary policy						
3-month interest rate	4.4	4.3	3.3	2.3	2.1	2.2
Long-term interest rate[1]	5.6	5.1	5.0	4.2	4.2	4.3
	Percentage changes from previous year					
Effective exchange rate						
Nominal	−2.5	+1.0	+1.4	+3.8	+0.9	+0.3
Real	−3.4	+0.3	+0.6	+2.8	+0.9	+0.7

Source: WIFO Economic Outlook. – [1] 10-year central government bonds (benchmark).

In 2005, the second and major part of the tax reform will take effect. The reform will lower the tax burden by € 1.5 billion, thereby weakening the government balance by around ¾ percent of GDP. The general government deficit in 2005 will be kept below 2 percent of GDP only if the tax cuts are partially offset by one-off measures (e.g., special dividends). The positive effects of the tax reform are reflected in the projection for GDP growth, which at 2½ percent in 2005 would be higher in Austria than in the euro area as a whole (+2.3 percent).