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Cyclical Revival in Sight

Economic Outlook for 2013 and 2014

Since the revision of the WIFO forecast of last September, the short-term outlook for the Austrian economy has improved somewhat. This is mainly due to the slight, but broad-based uptick of the leading indicators which suggests that a turning point of the business cycle may have been reached around the turn of the year. Yet, the profile of risk remains uneven and largely corresponds to the assessment of last autumn, with external downward risks somewhat dominating domestic upward risks. In such an environment, the Austrian economy is expected to grow by 1.0 percent in volume in 2013 and by 1.8 percent in 2014.

For definitions of terms used, see "Methodological Notes and Short Glossary", in this volume and http://www.wifo.ac.at/wwadocs/form/WIFO-BusinessCycleInformation-Glossary.pdf • All staff members of the Austrian Institute of Economic Research contribute to the Economic Outlook. Data processing: Nora Popp • Cut-off date: 18 December 2012. • E-mail address: Christian.Glocker@wifo.ac.at

Economic activity in Austria stagnated during the second half of 2012, while avoiding a cyclical recession. Given widespread fiscal restraint in the euro area and persistently difficult economic conditions in neighbouring countries, GDP growth is set to remain subdued over the entire forecast period. Leading indicators already point to the downward trend bottoming out. While these signals remain tentative for the time being, they are nevertheless observed for a larger number of variables. This gives ground to the expectation that the period of sluggishness will soon be overcome and allow demand and output to resume an upward trend. The current situation remains shaped by the (partly severe) adjustment recession in several euro area countries and the slackening of economic activity worldwide. While domestic fundamentals are still conducive to a sustained and broad-based cyclical upturn, a small open economy like Austria is highly dependent on demand stimulus from its external trading partners.

After a modest gain of 0.6 percent in 2012, real GDP growth in Austria will accelerate to 1.0 percent in 2013 and 1.8 percent in 2014. This projection rests on the assumption that the international government debt crisis remains under control, allowing the loss of confidence on the part of investors and consumers to gradually fade. Austria's GDP should thereby return to a path of moderate growth in the course of 2013, supported by prolonged easy monetary conditions and a pick-up of global economic activity. The projected growth path for the Austrian economy would on average over the period 2013-14 correspond to the estimated rate of potential output growth. Under the assumption of a slight decline in oil prices, inflationary pressure in Austria should remain contained. After an increase by 2.4 percent in 2012, the Consumer Price Index is projected to rise by 2.1 percent in 2013 and 2.0 percent in 2014. Besides a gradual, but steady gain in private consumption, investment is set to rebound over the entire forecast horizon. Employment will expand, but with labour supply growing in step, unemployment is likely to remain high.

The present projection remains subject to a high degree of uncertainty. In case the euro area economy recovers more quickly and global activity rebounds more strongly than assumed here, Austria's GDP growth could turn out higher, building upon the economy's strong fundamentals. Against such benign considerations should be set the non-negligible downward risks, such as a delayed recovery of the world economy or a new flare-up of the debt crisis in a number of countries.

Table 1: Main results

		2009	2010	2011	2012	2013	2014
		Percentage changes from previous year					
GDP							
Volume		– 3.8	+ 2.1	+ 2.7	+ 0.6	+ 1.0	+ 1.8
Value		– 2.3	+ 3.7	+ 5.0	+ 2.7	+ 2.9	+ 3.6
Manufacturing[1], volume		– 12.7	+ 7.0	+ 8.2	+ 1.5	+ 2.5	+ 4.0
Wholesale and retail trade, volume		– 0.3	+ 1.4	+ 1.3	– 1.0	+ 0.6	+ 1.2
Private consumption expenditure, volume		+ 1.1	+ 1.7	+ 0.7	+ 0.6	+ 0.7	+ 1.0
Gross fixed investment, volume		– 7.8	+ 0.8	+ 7.3	+ 0.8	+ 1.5	+ 2.0
Machinery and equipment		– 10.6	+ 6.0	+ 12.1	+ 0.5	+ 2.5	+ 3.0
Construction		– 7.1	– 2.7	+ 4.4	+ 1.1	+ 0.6	+ 1.1
Exports of goods[2]							
Volume		– 18.3	+ 13.0	+ 7.9	+ 0.8	+ 3.8	+ 6.0
Value		– 20.2	+ 16.7	+ 11.3	+ 1.7	+ 4.1	+ 7.1
Imports of goods[2]							
Volume		– 14.1	+ 10.9	+ 8.5	– 0.4	+ 3.5	+ 5.5
Value		– 18.4	+ 16.5	+ 15.3	+ 0.7	+ 3.7	+ 6.6
Current balance	billion €	+ 7.49	+ 9.74	+ 1.74	+ 6.30	+ 7.75	+ 9.01
As a percentage of GDP		+ 2.7	+ 3.4	+ 0.6	+ 2.0	+ 2.4	+ 2.7
Long-term interest rate[3]	percent	3.9	3.2	3.3	2.4	1.8	1.8
Consumer prices		+ 0.5	+ 1.9	+ 3.3	+ 2.4	+ 2.1	+ 2.0
Unemployment rate							
Eurostat definition[4]	percent	4.8	4.4	4.2	4.3	4.6	4.6
National definition[5]	percent	7.2	6.9	6.7	7.0	7.4	7.4
Persons in active dependent employment[6]		– 1.5	+ 0.8	+ 1.9	+ 1.4	+ 0.6	+ 0.9
General government financial balance according to Maastricht definition							
As a percentage of GDP		– 4.1	– 4.5	– 2.5	– 3.1	– 2.6	– 2.0

Source: WIFO Economic Outlook. – [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] According to Public Employment Service Austria, as a percentage of total labour force excluding self employed. – [6] Excluding parental leave, military service.

Global economic activity slackened markedly in the second half of 2012

With the exception of the first quarter 2012, global economic activity has been losing momentum since late 2011. While the crisis in the euro area has been the focus of the downturn, growth in the large emerging economies like China and Brazil also shifted into lower gear. The catching-up process of the rising markets has apparently slowed, while being at the same time increasingly driven by domestic demand.

The major retarding forces in the industrialised world derive from continued fiscal restraint and the lasting instability of the financial system. In most countries, consolidation is proceeding as planned, but carries strongly restrictive demand effects, mainly due to higher multiplier effects in the current difficult situation[1]. While the necessity of an overall reduction of public debt is not called into question, greater consideration should be given to the fact that budgetary cuts weigh more heavily on economic activity during a recession than in favourable cyclical conditions. In the financial system, capital allocation continues to lack efficiency; the sector is suffering from sluggish economic growth, a high stock of bad loans and the correction of asset prices on many countries' real estate markets. The resulting deleveraging is reinforced by the introduction of stricter equity capital rules (Basle III). Private access to capital is thus often facing high obstacles.

[1] Baum, A., Poplawski-Ribeiro, M., Weber, A., "Fiscal Multipliers and the State of the Economy", IMF Working Paper, 2012, (12/286).

According to macroeconomic risk indicators, the current economic environment is characterised by a low degree of uncertainty.

Apart from these "mechanical" forces, the current economic environment is characterised by a high degree of general uncertainty which, however, is not reflected by various macroeconomic indicators. For this reason, the "true" amount of uncertainty is difficult to assess. Of major concern are the unfolding of the European debt crisis and the appropriate policy reaction, as well as the fiscal policy stand-off ("fiscal cliff") in the USA. Geopolitical tensions further add to general uncertainty. These risk factors nevertheless seem to have been of limited impact on latest developments[2].

Known risk factors may mutually reinforce each other, like the possibility of a vicious circle being triggered by the quest for stable public finances and the quality of financial assets[3]. Such risk emerges from the increasing segmentation on Europe's financial markets which by now has gone a long way. Thus, the share of domestic government bonds in total sovereign bond assets held by banks increased between May 2010 and September 2012 from 63.3 percent to 72.7 percent in Germany, and from 45 percent to 69 percent in France. In the crisis countries of Europe's southern periphery this share is significantly higher, at around 99 percent in Italy, 97 percent in Greece, 94 percent in Spain and 90 percent in Portugal (see IMF, Fiscal Monitor), which reinforces the mutual dependency between governments and domestic credit institution. This dependency enhances the vulnerability of the system and thus the pressure for reform. The lack of an obligation to underlay government bonds with equity capital (unless in the case of exchange rate risk) favours the lop-sided asset allocation and thereby greatly enhances financial institutions' portfolio risks[4].

In strong contrast to these developments, various macroeconomic risk indicators have reached a long-time trough, thus pointing to a very low degree of uncertainty (VIX for the USA, VStoxx for Europe, VDAX-NEW for Germany, observed share price volatility of ATX for Austria[5]; Figure 1). With regard to these indices and the overall economic environment, no clear picture emerges as to the degree of uncertainty per se.

The extremely expansionary stance of monetary policy continues to provide positive stimulus. Central Banks are not only setting low policy-controlled interest rates, they increasingly operate also with unconventional measures to dampen market rates in order to give incentives for credit extension and supply financial institutions with sufficient liquidity. The sluggish underlying monetary dynamics and subdued credit extension to domestic private customers in many countries speak in favour of continued monetary easing over the forecast period.

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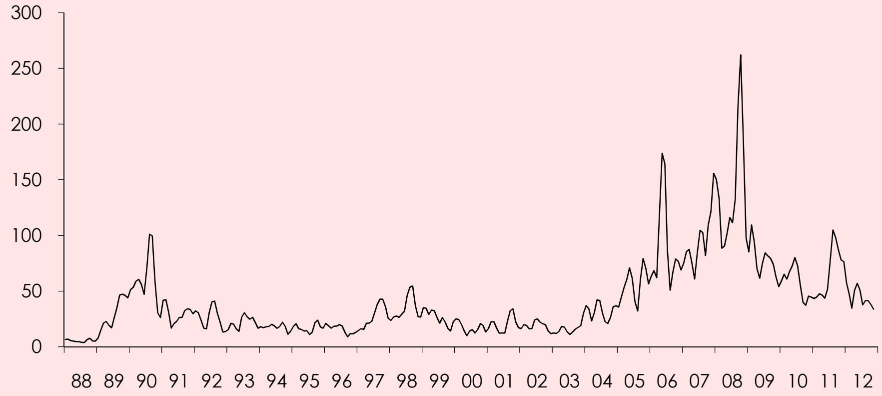
[2] A high degree of uncertainty has a dampening effect on a cyclical recovery and exacerbates a recession: Bachmann, R., Moscarini, G., "Business Cycles and Endogenous Uncertainty", University of Michigan Working Paper, 2011; Bloom, N., Floetotto, M., Jaimovich, N., Saporta-Eksten, N., Terry, S., "Really Uncertain Business Cycles", NBER Working Paper, 2012, (18245); Bloom, N., "The Impact of Uncertainty Shocks", Econometrica, 2009, 77(3), pp. 623-685.

[3] The rekindling of a negative feedback loop between the quality of banks' financial assets and several countries' sovereign risks is a key downward risk in the euro area. If banks tighten their lending standards and restrain credit growth to build up capital buffers, the implicit adverse effect on growth prospects may add to concerns about the sustainability of public debt and drive bond yields further up. This will prompt the governments concerned to reinforce fiscal restriction, dampening growth prospects even further. This in turn will deriorate the quality of banks' financial assets once again, due to losses on government bond prices and an higher defaults on private sector loans, requiring another tightening of credit rules. Such a vicious circle has a lasting depressive impact on the real economy.

[4] Such regulatory measures take the form of "financial repression", i.e. governments compelling banks to invest in their bonds with the aim of lowering interest rates or keeping them artificially down, or at a sufficiently high inflation rate generating negative real interest rates. Among such measures are also regulations that artificially boost demand for government bonds. Thus, the Basle III bank regulation reform "package" provides an incentive for banks to prefer sovereign bonds vis-à-vis other financial assets: while equity capital requirements are tightened for loans to households and non-financial corporations, there is still no such requirement for government bonds, except in the case of exchange rate risks (Zimmermann, G., Baier, F., "Financial Repression – Ein neues Umfeld für die Finanzmärkte?", Wirtschaftsdienst, Springer, 2012, 92(9), p. 599-604; Reinhart, C., Kirkegaard, J., Sbrancia, B., "Financial repression redux", MPRA Paper, 2011, (31641)).

[5] VIX, VStoxx and VDAX-NEW are implicit indices of share price volatility. Since there is no equivalent for the Austrian stock market, the observed volatility of the ATX is used here as a substitute for an implicit measure of volatility.

Figure 1: Observed ATX volatility



Source: WIFO calculations.

Spring 2013 should see a global cyclical recovery that advances most quickly in the emerging market economies.

Global economic activity looks set for an only muted expansion towards the end of 2012. The current sluggishness should, however, prove temporary, notably in the emerging market economies; in the absence of negative shocks such as in the context of the euro area debt crisis which would trigger new setbacks in confidence, growth should gradually accelerate as from spring 2013. World GDP is expected to increase by 3.3 percent in 2013 and by over 4 percent in 2014. Austria's trading partners in the euro area will see a more pronounced cyclical downturn and a more hesitant recovery than most other advanced industrial economies. Due to the close economic ties with the euro area, some trade partners in East-Central Europe will also be negatively affected. Growth of the US economy will be moderate over the years to come, albeit more dynamic than in Europe. The momentum will be held back by the expiry of fiscal measures which have so far sustained activity. The rising economies in southern and eastern Asia and Latin America, which have substantially gained importance for Austrian exporters over the last few years, should have overcome the current cyclical weakness by early 2013.

Table 2: World economy

	2009	2010	2011	2012	2013	2014
	Percentage changes from previous year					
Real GDP						
World	− 0.6	+ 5.1	+ 3.8	+ 3.3	+ 3.3	+ 4.0
USA	− 3.1	+ 2.4	+ 1.8	+ 2.3	+ 1.8	+ 2.4
Japan	− 5.5	+ 4.7	− 0.6	+ 1.7	+ 0.8	+ 1.3
EU 27	− 4.3	+ 2.1	+ 1.5	− 0.1	+ 0.6	+ 1.6
Euro area 16	− 4.4	+ 2.0	+ 1.4	− 0.3	+ 0.2	+ 1.2
Germany	− 5.1	+ 4.2	+ 3.0	+ 1.0	+ 1.0	+ 2.0
New EU countries[1]	− 3.2	+ 2.2	+ 3.2	+ 1.2	+ 1.5	+ 2.4
China	+ 9.2	+ 10.4	+ 9.2	+ 8.0	+ 7.0	+ 8.0
World trade, volume	− 12.7	+ 15.2	+ 5.8	+ 3.5	+ 3.8	+ 6.0
Market growth[2]	− 10.8	+ 11.4	+ 6.2	+ 1.8	+ 3.8	+ 6.0
Primary commodity prices						
HWWI index, total	− 34.7	+ 28.9	+ 28.6	− 4.0	− 8	+ 5
Excluding energy	− 28.4	+ 31.9	+ 19.2	− 15.0	± 0	+ 15
Crude oil prices						
Brent, $ per barrel	61.5	79.5	111.3	111.0	100	102
Exchange rate						
$ per euro	1.393	1.327	1.392	1.280	1.28	1.28

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

Sluggish world trade is dampening the expansion of Austria's exports.

World trade is at present shaped by the slowdown of global business activity and a lower trade intensity of growth. The latter is probably closely related to the cyclical sluggishness of manufacturing. Over the forecast horizon, trade intensity of growth should rebound without, however, returning to the high level observed before the onset of the financial market crisis and the subsequent deep recession. In step with the profile of world GDP, global trade is projected to grow still below average in 2013, accelerating to +6 percent in 2014. Austrian manufacturers will feel the slackness of demand across Europe for still some time. Indeed, export markets may expand considerably more slowly in 2013 than in the years before. The export projection for the current year is therefore revised down slightly from the forecast round of last autumn. By 2014, the expected cyclical revival in the euro area should give fresh momentum to export market growth.

Commodity prices look set to ease over the forecast period.

After a temporary easing of oil market conditions, prices have picked up again recently. Oil futures quotations have nevertheless been heading down for some time. Accordingly, the oil price projection has been revised down somewhat, starting from an annual average of $ 111 per barrel of Brent in 2012 to $ 100 in 2013 and $ 102 in 2014. Prices for other commodities have reacted markedly to the cyclical slowdown, with cuts being most notable for food, beverages and tobacco. The latest cuts are a correction of the sharp hikes during last summer. Overall, non-energy commodity prices, after their slump in 2012 may decline somewhat further in 2013, before rebounding on annual average 2014.

Leading indicators draw a mixed, but increasingly positive picture for the Austrian economy and signal an imminent turning point in the cycle.

Since last September, the overall picture delivered by the leading indicators for the Austrian economy has brightened up. While at the time almost all indicators were heading clearly down, many of them are now pointing to an nascent recovery. Taken in isolation, many series show just a one-time improvement for the time being, which should be taken with caution. Yet, such improvement can be observed for a considerable number of indicators, which confirms the probability of a cyclical turning point. In particular, the WIFO Leading Indicator and Bank Austria's Purchasing Managers Index pointed lately to a bottoming out of the decline in domestic manufacturing. This raises the likelihood of a cyclical upturn getting under way in the first half of 2013. While the rise in the WIFO Leading Indicator is still tentative, an improvement is shown across almost all components. Among the components of the Purchasing Managers Index the stabilisation of output is eye-catching, driven by a stronger order inflow, notably from domestic clients. Likewise, the Purchasing Managers Index for the euro area jumped unexpectedly in December.

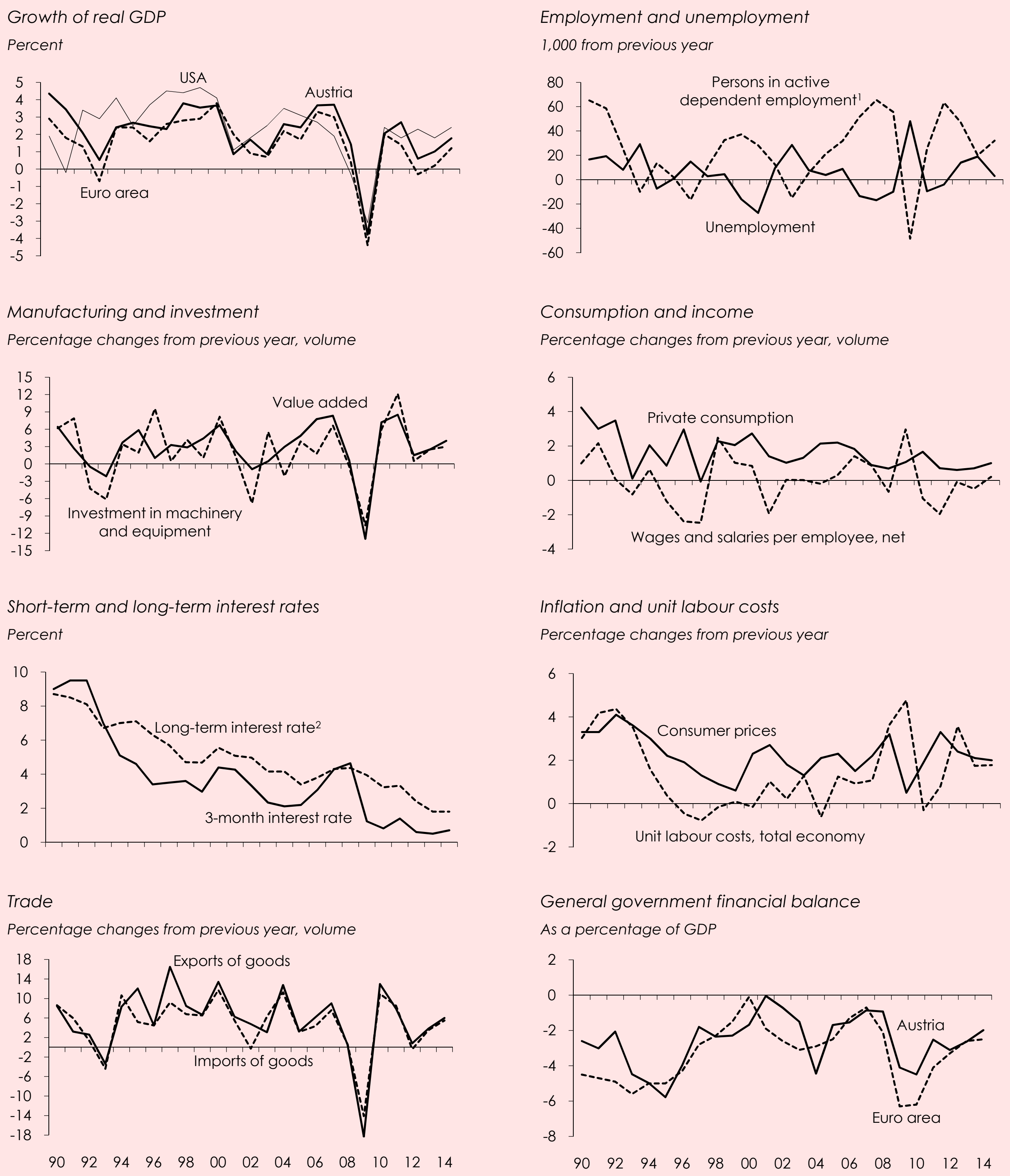
Cyclical indicators are brightening up also for the global economy.

In the USA, consumer confidence rose last November to its pre-crisis level. The improvement was largely driven by a better labour market outlook. Positive signs also came from the real estate market. The S&P/Case-Shiller Index (20 cities) climbed in August 2012 for the seventh month in a row, after having declined for almost two years. The Purchasing Managers Index (PMI) followed an upward path in recent months, but edged down in November.

In China, the gain in industrial output in November was the highest since last spring. After a one-year pause, industrial production climbed by 10.1 percent according to the latest figures. Positive signs are also reported by the Purchasing Managers Index (from HSBC) which for the first time since October 2011 rose above the threshold of 50 points, a reading that signals economic expansion.

German manufacturing industry registered in autumn surprisingly positive order inflows (in October +3.8 percent from the previous month). Early indicators like the Ifo Business Climate Index headed up for the first time from a longer downward trend, with an improvement notably of the expectations component. Likewise, positive expectations are reflected by the ZEW Indicator of the Centre for European Economic Research (Zentrum für Europäische Wirtschaftsforschung) which jumped from –15.7 in November to +6.9 in December, the strongest increase since last February to the highest reading since May 2012. However, the consumer climate in Germany weakened somewhat, with the upward trend of the previous months levelling off and the index stabilising at a high level.

Figure 2: Indicators of economic performance



Source: WIFO Economic Outlook. – [1] Excluding parental leave, military service, and unemployed persons in training. – [2] 10-year central government bonds (benchmark).

Leading indicators are turning increasingly positive also for the euro area, largely reflecting the better assessment in Germany. Output expectations and order levels have improved, as has the business confidence indicator for the manufacturing sector. Developments in the euro area remain nevertheless determined by the adjustment process in the periphery countries where the stagnation or fall in business activity may prove more severe and drawn-out than anticipated. The improvement in the survey indicators will be reflected in hard data only with a lag of several months.

In the third quarter 2012, euro area real GDP shrunk once again and unemployment rose to a new peak, with youth unemployment being particularly high. Moreover, like in the USA, long-term unemployment has increased markedly, giving rise to social problems like loss of qualification and motivation, with labour market slack thereby becoming entrenched.

Nevertheless, those countries which are most severely hit by the government debt crisis have already achieved certain progress in their adjustment process: current account deficits have narrowed – and not only due to painful cuts in domestic demand. Also an adjustment of cost structures has come under way, and companies gradually succeed in entering new foreign markets. In the course of 2013 therefore, the euro area economy should stabilise and, after having passed the trough of the cycle, start recovering, even if hesitantly in the early stage[6]. Necessary preconditions for this to occur are that a rekindling of the banking and sovereign debt crisis can be avoided and that fiscal consolidation and structural reform are carried forward unabated.

Austria's economy benefiting from sound fundamentals

Against the background of worldwide sluggishness, the Austrian economy has proved resilient over the last months. Austria is, like Germany, among those countries in the euro area that have been spared from recession. GDP edged up by 0.3 percent quarter-on-quarter in the first three months of 2012, and by 0.1 percent in the following period. While consumer demand was stable in the first half of the year, investment receded. Net exports provided a significant positive growth contribution in the first quarter, but no longer in the second quarter due to a pick-up in imports. GDP growth in the first semester was thus sustained both by domestic and, to a lesser extent, foreign demand. A similar pattern was observed for the third quarter. In the whole year 2012, the Austrian economy thus provided firm support to business activity in the euro area.

During the last months, the assumptions underlying the forecast of autumn 2012 have not been undermined by a global macroeconomic shock. Worldwide business conditions have provided little growth stimulus, demand from the euro area is weakening, and domestic orders largely mirror firms' low appetite for investment. GDP growth in the fourth quarter 2012 thus promises to be anaemic, a slight decline not being excluded. Like last September, the current projection anticipates a gradual ebbing of the European confidence crisis and a normalisation of business conditions in Austria as in the euro area. Under the further assumptions of global growth overcoming its "soft patch" and the euro area being spared further negative shocks, confidence should gradually be restored and demand from the euro area cease to fall. This should allow GDP growth in Austria to gather pace, from a rate of 0.6 percent in 2012 to a projected 1.0 percent and 1.8 percent in 2013 and 2014, respectively. Compared with the projection of last September, short-term growth expectations thereby remain unchanged under the key assumptions that the euro area debt crisis will not rekindle, that structural reform efforts are sustained and that the adjustment-induced recession will soon taper off.

While growth of the Austrian economy over the forecast horizon will on average match the estimated rate of potential output growth, the output gap will not close.

Over the forecast period (2013 and 2014), average GDP growth may match the trend rate of potential output growth, i.e. 1½ percent p.a. A pick-up of demand from third countries for Austrian goods and services is crucial for the expected cyclical upswing to materialise. Only in the medium term can a revival of demand from the euro area be expected. As confidence strengthens gradually, corporate investment should rebound, supported by highly favourable internal and external financing conditions.

[6] See WIFO Press Release of 12 December 2012: "Griechenland, Spanien, Portugal: Konsolidierung ohne aktiven Wachstumsschub unrealistisch. Ein Policy Brief zu Entwicklungsoptionen der peripheren EU-Länder", http://www.wifo.ac.at/wwa/pubid/45982.

Temporary export slack due to delayed recovery in the euro area

The current export performance largely reflects the sluggish growth of external markets. In 2012, many of Austrian export markets in the euro area even contracted slightly. Exports nevertheless edged up over most of 2012 (first quarter +0.4 percent in volume from the previous period, second quarter +0.6 percent, third quarter +1.0 percent). The lower turning point of the export profile is expected for the fourth quarter 2012, with deliveries probably no higher than one year ago. The projection for the entire year 2012 is for a modest increase of volume exports by 0.8 percent. As from early 2013, export markets should revive, making for a gentle, but steady acceleration of the export momentum (2013 +3.8 percent in real terms). Only by 2014 will export growth reach nearly 6 percent, close to its long-term average, thanks to a strengthening of demand abroad and gains in price competitiveness (stagnating terms-of-trade, declining unit labour cost). Exports towards third countries will gain importance over the entire forecast horizon.

Since exports are expected to rise faster than imports, the trade balance should improve somewhat over the projection period.

Import volumes in 2012 (–0.4 percent) will clearly lag behind export growth, mainly due to the restraint in private investment, given that a large part of domestic investment in machinery and equipment are imported goods. The expected pick-up of investment and exports will give fresh momentum to imports over the forecast period (2013 +3,5 percent, 2014 +5,5 percent in volume). Moreover, import intensity is heading up whenever exports and machinery investment gather momentum. The share of the euro area in Austrian imports is unlikely to diminish.

Machinery investment gaining strength

The decline in investment in 2012 has two reasons: first, slackening global demand and subdued domestic activity weigh on sales expectations; second, capacity utilisation remains significantly below its long-term average. This weighs particularly on capacity-enhancing investment.

Despite favourable internal and external financing conditions, the latest WIFO Business Survey Indicates rising obstacles in access to credit.

The investment-dampening effects should be set against substantial positive influence factors, such as favourable conditions for internal and external financing. The cost of external financing is extraordinarily low, the real interest rate for corporate credit is close to zero or even negative; equally favourable are financing options via the bond and stock markets: the ATX gained over 30 percent since early 2012, reaching its annual high in December. Despite the cyclical weakness, banks' credit extension to private companies increased by 3 percent during the year, compared with a decline for the euro area as a whole. For the time being, there are no signs of supply-side credit shortages, although the latest WIFO Business Survey pointed to a slight increase in credit constraints. The share of companies requiring credit financing remains at 23 to 24 percent, whereas the availability of credit varies, as in earlier surveys, by company size and economic sector: at present, manufacturing companies enjoy the highest probability of obtaining a loan of the expected amount and at the expected conditions (52 percent; in November 2011: 70 percent). Almost one-third of the sampled companies judge banks' current lending standards as restrictive, only 7 percent as accommodating. Among the companies actually requiring credit, views on lending standards are even more critical.

With the projected gradual improvement of external conditions, investment will also recover. Against this background, corporate spending on machinery and equipment will accelerate from +0.5 percent in 2012 to +2.5 percent in 2013 and +3.0 percent in 2014. According to the latest WIFO Investment Survey, 2013 should see a strong increase in manufacturing investment, particularly in the consumer goods branches and somewhat less in the cyclically more sensitive primary and investment goods industries.

Private consumption gradually picking up

In 2012, private consumption rose by a modest 0.6 percent, although employment reached a new peak. Lively job creation was, however, accompanied by only lean gains in real earnings and household incomes. Besides, the continued negative wage drift also had some dampening effect.

Over the forecast horizon, real household income will stay on a moderate upward path, despite the expected rebound of demand and output and the easing of inflation. Consumption growth is therefore unlikely to pick up substantially (+0.7 percent in real terms in 2013), since households will also seek to revert to a higher saving ratio: the latter had climbed from below 8 percent of disposable income in 2002 to 11.5 percent before the onset of the financial market crisis, but by 2012 had dropped back to the level of 2002. The sluggish rise in disposable income since 2009 and the desire of households to broadly maintain consumption standards (particularly for the needs of daily life) are clearly reflected by "dissaving", i.e., a falling saving ratio. The consumption projection implies that the saving ratio will stay broadly flat in 2013 (2012: 7.5 percent; 2013: 7.6 percent). In 2014, when consumption growth should pick up to 1 percent, still higher gains in disposable income will lift the saving ratio to 7.9 percent.

Table 3: Private consumption, income and prices

	2009	2010	2011	2012	2013	2014
	Percentage changes from previous year					
Private consumption expenditure	+ 1.1	+ 1.7	+ 0.7	+ 0.6	+ 0.7	+ 1.0
Durables	+ 4.8	+ 2.3	+ 1.8	− 3.1	− 0.5	+ 1.0
Non-durables and services	+ 0.6	+ 1.6	+ 0.6	+ 1.0	+ 0.8	+ 1.0
Household disposable income	+ 0.3	− 0.6	− 0.9	+ 0.5	+ 0.7	+ 1.3
	As a percentage of disposable income					
Household saving ratio[1]	11.2	9.1	7.4	7.5	7.6	7.9
Household saving ratio[2]	10.6	8.6	7.1	7.0	7.1	7.3
	Percentage changes from previous year					
Direct lending to domestic non-banks[3]	− 1.3	+ 2.9	+ 2.6	+ 1.4	+ 2.1	+ 2.6
	Percentage changes from previous year					
Inflation rate						
National	0.5	1.9	3.3	2.4	2.1	2.0
Harmonised	0.4	1.7	3.6	2.5	2.2	2.0
Core inflation[4]	1.5	1.2	2.8	2.2	2.0	1.9

Source: WIFO Economic Outlook. – [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.

Increase in labour supply and employment – jobless rate rising

In spite of subdued business activity, the number of dependent workers and employees rose unusually strongly in 2012. A gain of that order has in the past been achieved only at significantly higher rates of output growth, whereas at present the economy is close to stagnation. Since, however, job creation was outpaced by the increase in labour supply, the number of unemployed went up. The jobless rate has ratcheted up markedly over the last 12 months, which is more in line with overall business conditions.

In spite of sustained employment growth, the unemployment rate will stay high over the forecast period.

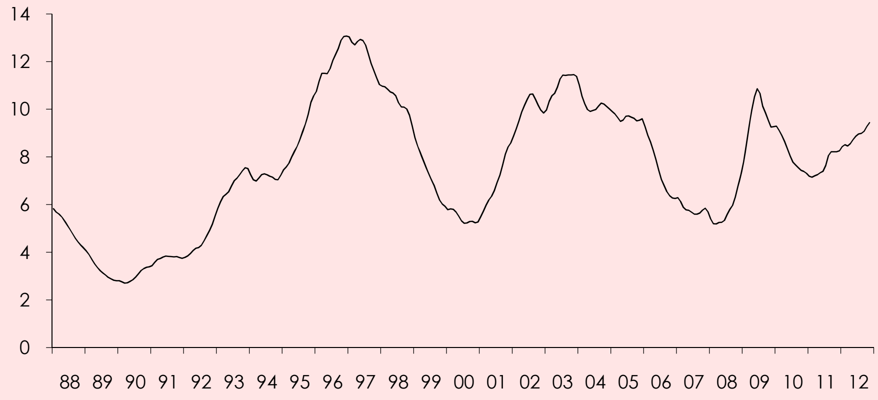
The latest cyclical slowdown had negative repercussions also on the Austrian labour market and continued an adverse trend that had set in earlier. Since the third quarter 2011, leading indicators had signalled a steady weakening of labour market conditions. This is clearly revealed by the relation between the number of unemployed and that of reported job vacancies (Figure 2): the number of jobseekers has been on the rise as from mid-2011, while job vacancies reached a peak in early 2011 and have been steadily declining since.

The effects of labour market liberalisation should fade over the forecast horizon. While the inflow of foreign workers remains the key driver of growing labour supply, the move to a slower pace will dampen employment growth overall. At the same time, domestic labour supply is boosted by rising labour force participation of older workers.

The WIFO projection for 2013 and 2014 is for a moderation of employment growth to rates of +0.6 percent and +0.9 percent, respectively. The unemployment rate is edging up to 7.0 percent in 2012, maintaining a high level of 7.4 percent in the two subsequent years.

Figure 3: Labour market conditions

Unemployment per vacancy ratio, seasonally adjusted



Source: WIFO calculations.

Table 4: Labour market

		2009	2010	2011	2012	2013	2014
		Changes from previous year, in 1,000					
Demand for labour							
Persons in active employment[1]		– 44.0	+ 32.4	+ 70.4	+ 51.3	+ 25.0	+ 37.0
Employees[2]		– 48.5	+ 25.5	+ 63.3	+ 47.0	+ 20.0	+ 32.0
Percentage changes from previous year		– 1.5	+ 0.8	+ 1.9	+ 1.4	+ 0.6	+ 0.9
Nationals		– 43.0	+ 5.8	+ 25.7	+ 8.5	+ 2.0	+ 7.0
Foreign workers		– 5.5	+ 19.7	+ 37.7	+ 38.5	+ 18.0	+ 25.0
Self-employed[3]		+ 4.5	+ 6.9	+ 7.1	+ 4.3	+ 5.0	+ 5.0
Labour supply							
Population of working age	15 to 64 years	+ 17.3	+ 21.6	+ 37.0	+ 15.6	+ 3.0	+ 5.5
	15 to 59 years	+ 11.1	+ 8.9	+ 17.1	+ 19.5	+ 7.2	+ 5.3
Labour force[4]		+ 4.0	+ 22.9	+ 66.3	+ 65.3	+ 44.0	+ 40.0
Surplus of labour							
Registered unemployed[5]		+ 48.1	– 9.5	– 4.1	+ 14.0	+ 19.0	+ 3.0
In 1,000		260.3	250.8	246.7	260.7	279.7	282.7
Unemployed persons in training[5]	in 1,000	64.1	73.2	63.2	66.6	71.6	71.6
		In percent					
Unemployment rate							
Eurostat definition[6]		4.8	4.4	4.2	4.3	4.6	4.6
As a percentage of total labour force[5]		6.5	6.2	6.0	6.3	6.6	6.7
National definition[5,7]		7.2	6.9	6.7	7.0	7.4	7.4
Employment rate							
Persons in active employment[1,8]		64.7	65.1	65.9	66.6	67.0	67.6
Total employment[6,8]		71.6	71.7	72.1	72.6	72.9	73.3

Source: WIFO Economic Outlook. – [1] Excluding parental leave, 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] As a percentage of total labour force, excluding self-employed. – [8] As a percentage of population of working age (15 to 64 years).

Small real wage gains

The wage settlements of 2012 suggest an average increase in private sector contractual wages of just over 3 percent. As in 2012, the wage drift is expected to be negative in 2013, making for a somewhat smaller gain in per-capita earnings. In the context of the 2012 fiscal consolidation package, a zero wage round is planned for the public sector for 2013, followed by a small increase in 2014. After an increase in gross nominal wages and salaries per employee by 2.7 percent in 2012, a gain of 2.0 percent is expected for 2013. Adjusted for inflation, the gross real gain in earnings per employee is 0.3 percent for 2012, the projection for 2013 implies a small loss of 0.1 percent. In 2014, with inflation abating and activity reviving, gross nominal wages and salaries per employee may advance by 2½ percent, yielding a gross real wage gain of 0.5 percent.

Table 5: Earnings and international competitiveness

	2009	2010	2011	2012	2013	2014
	Percentage changes from previous year					
Gross earnings per employee[1]	+ 1.7	+ 1.0	+ 1.7	+ 2.7	+ 2.0	+ 2.5
Gross real earnings per employee[2]	+ 1.2	– 0.8	– 1.5	+ 0.3	– 0.1	+ 0.5
Net real earnings per employee[2]	+ 3.0	– 1.1	– 2.0	– 0.1	– 0.5	+ 0.2
Unit labour costs						
Total economy	+ 4.8	– 0.3	+ 0.8	+ 3.6	+ 1.7	+ 1.8
Manufacturing	+11.5	– 6.1	– 3.9	+ 2.8	– 0.5	– 1.1
Effective exchange rate, manufactures						
Nominal	+ 0.7	– 2.6	+ 0.0	– 1.5	+ 0.1	+ 0.1
Real	+ 0.4	– 2.7	+ 0.7	– 1.5	+ 0.1	+ 0.1

Source: WIFO Economic Outlook. – [1] Employees according to National Accounts definition. – [2] Deflated by CPI.

Unit labour cost and GDP deflator edging down

With job creation buoyant, but GDP growth faltering, productivity declined. Thus, unit labour cost is likely to rise markedly in 2012 (manufacturing +2.8 percent, overall economy +3.6 percent). Against this background, the index of contractual wages may rise by no more than 2.3 to 2.4 percent in 2013. Over the forecast period, moderate real wage growth and a pick-up in labour productivity advances (due to the cyclical recovery and subsiding employment growth) will dampen unit labour cost markedly (manufacturing 2013 –0.5 percent, 2014 –1.1 percent). This should also put a lid on manufactures price inflation.

Table 6: Productivity

	2009	2010	2011	2012	2013	2014
	Percentage changes from previous year					
Total economy						
Real GDP	– 3.8	+ 2.1	+ 2.7	+ 0.6	+ 1.0	+ 1.8
Employment[1]	– 0.9	+ 0.7	+ 1.8	+ 1.5	+ 0.8	+ 1.1
Productivity (GDP per employment)	– 2.9	+ 1.4	+ 0.9	– 0.9	+ 0.2	+ 0.6
Manufacturing						
Production[2]	–13.0	+ 7.2	+ 8.5	+ 1.5	+ 2.5	+ 4.0
Employees[3]	– 5.3	– 1.3	+ 1.9	+ 1.7	± 0.0	+ 0.3
Productivity per hour	– 4.7	+ 5.4	+ 6.6	+ 0.3	+ 3.2	+ 3.3
Working hours per day per employee[4]	– 3.5	+ 3.0	– 0.1	– 0.5	– 0.7	+ 0.4

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.

On account of a moderate increase in profit margins and falling unit labour cost, the rise in the GDP deflator remains subdued (2013 +1.9 percent, 2014 +1.8 percent). In 2014, the downward trend in unit labour cost should be the main driver of decelerating inflation.

Consumer price inflation abating

Inflation, as measured by the change in the national Consumer Price Index, was moderate in the first half of 2012. The acceleration observed since the middle of 2012 (September 2.7 percent, October 2.8 percent, November 2.8 percent) should prove short-lived; it was mainly the result of higher prices for food and energy for household consumption. The forecast anticipates an easing of oil prices, such that a moderation of inflation should be facilitated by the external as well as by the domestic component.

The slight decline in raw material prices and an only moderate increase in unit labour cost should ease inflationary pressure in Austria.

Headline inflation overall is forecast to abate from 2.4 percent in 2012 to 2.1 percent in 2013 and 2.0 percent in 2014. Should the downward adjustment of commodity prices persist and the euro exchange rate stabilise earlier than expected (forecast assumption: 1.28 $ per Euro), inflation may decelerate more quickly, notably in 2013. Inflationary pressure from the supply side will remain small over the entire forecast horizon, since the potential output gap will not have closed by the end of 2014.

Government debt ratio not to decline before 2014

Since 2008-09, the economic crisis has left deep marks in government households. At 74.6 percent of GDP in 2012, the public debt ratio is already high, and it is set to rise further by a significant amount in 2013. Reasons are the current new government borrowing, Austria's contribution towards debt stabilisation in the euro area, and potential further financial support for domestic banks in distress. Although the gross debt amounts related to domestic financial market support and to the European Stabilisation Mechanism (EFSF/ESM) ought to be set against the corresponding financial claims, the latter are subject to certain risks. After a further increase in 2012 and 2013, the government debt ratio should start heading down in 2014.

Table 7: Key policy indicators

	2009	2010	2011	2012	2013	2014
	As a percentage of GDP					
Fiscal policy						
General government financial balance						
According to Maastricht definition	− 4.1	− 4.5	− 2.5	− 3.1	− 2.6	− 2.0
General government primary balance	− 1.3	− 1.8	+ 0.1	− 0.5	− 0.0	+ 0.6
	In percent					
Monetary policy						
3-month interest rate	1.2	0.8	1.4	0.6	0.5	0.7
Long-term interest rate[2]	3.9	3.2	3.3	2.4	1.8	1.8
	Percentage changes from previous year					
Effective exchange rate						
Nominal	+ 0.9	− 2.5	+ 0.1	− 1.5	+ 0.1	+ 0.1
Real	+ 0.4	− 2.7	+ 0.8	− 1.5	+ 0.1	+ 0.1

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

The situation of public finances over the forecast period is shaped, on the one hand, by the cyclical recovery, and by the consolidation programme, on the other. The deficit/GDP ratio will go down from 3.1 percent in 2012 to 2.6 percent in 2013 and 2.0 percent in 2014. The uncertainties surrounding the present projection constitute a downward risk also in this area: possible additional liquidity injections for nationalised banks may push up the deficit for both 2012 and 2013. It is also doubtful whether additional revenues expected from the ex-ante taxation of contributions to occupational pension schemes will actually accrue to full extent in 2012. Revenues on the basis of the taxation agreement with Switzerland will probably fall considerably short of the € 1 billion budgeted for 2013. Further uncertainties relate to the actual implementation of certain consolidation measures on the tax side, notably for 2013 and 2014.

The risk environment

The present forecast has been prepared in a period that is characterised by a high degree of uncertainty which, however, is not fully reflected by the relevant macroeconomic indicators. The greater calm prevailing on financial markets since last August has only lately been mirrored by confidence indicators; firms have turned more optimistic mainly in their expectations for the months to come. The major forecast risks relate nevertheless to the policy environment, such as the outcome of the budget dispute in the USA (fiscal cliff) or the necessary policy measures to solve the confidence crisis in Europe. New risks emanate from domestic policy developments in Italy which may give rise to new tensions on financial markets. The adjustment processes in several euro area countries may take more time than anticipated, which may weigh on public sentiment and undermine the acceptance of reform. To counter such danger, it would be desirable if policy acted decisively to strengthen general confidence in the eventual success of the adjustment process. Further risks for the world economy derive from potential geopolitical conflicts, such as in the Middle East and in the Arab World or the territorial dispute between China and Japan.

External downward risks continue to dominate the margin of uncertainty surrounding the projections.

On the other hand one may well conceive a scenario where positive news move to the forefront and confidence spreads more quickly than assumed here. In such event, the Austrian economy will benefit from its sound fundamentals and may use the new opportunities in a new investment cycle.

Domestic demand in Austria holds clear upside risks. Given the highly satisfactory corporate earnings situation, investment may rebound more vigorously once sales prospects become brighter. If confidence were to return earlier, private households may, on their part, revise their plans for higher precautionary saving and rather reinforce the dynamics of private consumption.