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Business Activity Gathering Pace Only Gradually

Economic Outlook for 2014 and 2015

Business Activity Gathering Pace Only Gradually. Economic Outlook for 2014 and 2015

Towards the end of 2013, activity rebounded in Austria as well as in Europe overall. However, the momentum promises to remain subdued: many countries are still struggling with the repercussions of the financial market crisis, and the need for consolidation of government households is restraining the growth of demand. The Austrian economy is projected to grow by 1.7 percent each in 2014 and 2015 – a pace too slow to rein back unemployment. Inflation is receding, though remaining high when compared with other EU member countries.

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The emerging market economies which have so far stimulated global activity, have moved to a much slower growth path since last year, while showing wide regional differences. The US economy keeps following a stable upward trend and activity should gain momentum in 2014 and 2015.

In the euro area, the recovery of demand and output remains sluggish. The financial market crisis is still not overcome, and fiscal policy requires restraint on expenditure in most member countries. With the recession having bottomed out in 2013, growth should resume at a modest 1 percent this year, strengthening to 1.5 percent in 2015.

The markets in east-central Europe, which are important for the Austrian economy, have taken a positive turn since 2013. Yet, high private sector indebtedness is weighing on growth of aggregate demand, such that the process of catching-up towards the most advanced EU member countries has slowed down from the period before the crisis.

In such an environment of limited external growth incentives, the export-oriented Austrian economy can hardly achieve substantial output gains. Although volume exports of goods should increase by 5½ percent in 2014, twice the rate of the previous year, the momentum is markedly weaker than in earlier periods of cyclical upturn. While the measures of fiscal consolidation will weigh on domestic demand, private consumption and investment will nevertheless pick up. After a decline in real terms of 0.2 percent in household spending and of 0.9 percent in gross fixed investment last year, 2014 should see a rebound of 0.8 percent and 3 percent, respectively. In 2015, private consumption is expected to accelerate, while growth of investment is likely to abate.

Overall, the Austrian economy is projected to grow by only 1.7 percent each in 2014 and 2015, a pace too slow to allow unemployment to decline. The jobless figure will rise above 300,000 in 2014 and is expected to reach a total of 314,000 in 2015, while labour supply and employment will both increase in parallel. The unemployment rate, on national definition, will climb to 8 percent of the dependent labour force and edge further up in 2015.

Latest information on the scope and time profile of the budget burden implied by the financial support to Hypo Alpe-Adria-Bank AG suggests that the general government deficit will jump to 3 percent of GDP in 2014. In the absence of this burden, the deficit ratio would equal 2.1 percent. From today's perspective, the fiscal gap would narrow to –1.2 percent of GDP in 2015, subject however to a considerable margin of uncertainty.

Table 1: Main results

		2010	2011	2012	2013	2014	2015
		Percentage changes from previous year					
GDP							
Volume		+ 1.8	+ 2.8	+ 0.9	+ 0.4	+ 1.7	+ 1.7
Value		+ 3.2	+ 4.9	+ 2.6	+ 2.0	+ 3.5	+ 3.7
Manufacturing[1], volume		+ 7.6	+ 8.3	+ 1.1	+ 1.1	+ 3.5	+ 4.2
Wholesale and retail trade, volume		+ 2.2	+ 1.3	– 1.7	– 1.4	+ 1.3	+ 2.0
Private consumption expenditure, volume		+ 2.0	+ 0.8	+ 0.5	– 0.2	+ 0.8	+ 1.0
Gross fixed investment, volume		– 1.4	+ 8.5	+ 1.6	– 0.9	+ 3.0	+ 2.1
Machinery and equipment		+ 2.1	+ 14.3	+ 2.1	– 3.1	+ 5.0	+ 3.0
Construction		– 3.9	+ 2.5	+ 2.5	+ 0.7	+ 1.2	+ 1.3
Exports of goods[2]							
Volume		+ 13.6	+ 8.1	+ 0.8	+ 2.7	+ 5.5	+ 6.5
Value		+ 16.7	+ 11.3	+ 1.5	+ 1.5	+ 6.2	+ 7.7
Imports of goods[2]							
Volume		+ 11.7	+ 8.6	– 1.3	+ 0.2	+ 5.5	+ 6.0
Value		+ 16.5	+ 15.3	+ 0.7	– 1.5	+ 6.0	+ 7.0
Current balance	billion €	+ 9.74	+ 4.90	+ 4.93	+ 8.60	+ 10.67	+ 12.50
As a percentage of GDP		+ 3.4	+ 1.6	+ 1.6	+ 2.7	+ 3.3	+ 3.7
Long-term interest rate[3]	percent	3.2	3.3	2.4	2.0	1.8	1.9
Consumer prices		+ 1.9	+ 3.3	+ 2.4	+ 2.0	+ 1.9	+ 1.9
Unemployment rate							
Eurostat definition[4]	percent	4.4	4.2	4.3	4.9	5.2	5.3
National definition[5]	percent	6.9	6.7	7.0	7.6	8.0	8.1
Persons in active dependent employment[6]		+ 0.8	+ 1.9	+ 1.4	+ 0.6	+ 1.0	+ 1.0
General government financial balance according to Maastricht definition							
As a percentage of GDP		– 4.5	– 2.5	– 2.5	– 1.9	– 3.0	– 1.2

Source: WIFO. 2014, 2015: forecast. – [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.

1. Upswing in the USA is fuelling global activity

The revival of global economic activity continued in the second half of 2013, with particularly the US economy providing strong incentives. In the EU, on the other hand, demand and output picked up only tentatively. In the Asian emerging markets, activity strengthened markedly, as output rose strongly in the latter part of the year. In Latin America, capital outflows and currency depreciation left negative marks as industrial production even contracted in the second semester. WIFO projects a further upswing in global business activity, with regional differences however remaining important.

For some time now, the forces of growth have been shifting from the emerging markets towards the industrialised economies. This trend is expected to continue throughout 2014 and 2015. Notably the US economy looks set to expand forcefully.

After a "soft patch", growth in the USA picked up as from mid-2013. In the fourth quarter, demand shifted from investment towards private consumption and net exports. Private consumption as the major component of aggregate demand in the USA recorded the strongest quarterly growth since the beginning of 2012, rising by +0.6 percent. Gains extended to both durable (+0.6 percent in volume) and non-durable (+0.9 percent) consumer goods. Since disposable income at the same time remained flat quarter-on-quarter, the private household saving ratio dropped from 4.9 percent to 4.5 percent.

Several factors are behind the likely continuation of the US recovery. House prices have been rising steadily for two years by now, and private household indebtedness is declining. The uncertainty emanating from the political difficulties surrounding the federal budget in late 2013 and early 2014 has abated for the time being. These elements, together with the lasting improvement on the labour market and the planned increase in minimum wages should lend further support to private consumption. Moreover, with the general brightening of business conditions and robust export gains, corporate investment is set to pick up significantly over the forecast horizon. The marked decline in energy imports due to the intensifying exploitation of shale oil and shale gas is putting a lid on import growth. Hence, the USA current account deficit is unlikely to return to levels recorded before 2007, despite the cyclical upturn and buoyant consumption growth. The favourable short-term prospects are mirrored by the results from business and consumer surveys. WIFO expects USA real GDP to grow by 2.7 percent in 2014 and 3.1 percent in 2015.

Table 2: World economy

	2010	2011	2012	2013	2014	2015
	Percentage changes from previous year					
Real GDP						
World	+ 5.2	+ 3.8	+ 3.1	+ 3.0	+ 3.5	+ 3.8
USA	+ 2.5	+ 1.8	+ 2.8	+ 1.9	+ 2.7	+ 3.1
Japan	+ 4.7	– 0.5	+ 1.4	+ 1.5	+ 1.4	+ 1.2
EU 28	+ 2.0	+ 1.7	– 0.4	+ 0.1	+ 1.5	+ 1.9
Euro area 18	+ 2.0	+ 1.6	– 0.7	– 0.4	+ 1.1	+ 1.5
CEEC 5[1]	+ 3.1	+ 3.2	+ 0.6	+ 0.9	+ 2.5	+ 2.9
China	+ 10.4	+ 9.3	+ 7.7	+ 7.7	+ 7.6	+ 7.3
World trade, volume	+ 14.5	+ 6.2	+ 1.9	+ 2.7	+ 5.5	+ 6.5
Market growth[2]	+ 14.5	+ 7.5	+ 1.3	+ 1.7	+ 5.5	+ 6.5
Primary commodity prices[3]						
HWWI index, total	+ 28.9	+ 28.6	– 2.8	– 2.0	+ 1	± 0
Excluding energy	+ 31.9	+ 19.2	– 14.4	– 6.0	± 0	± 0
Crude oil prices						
Brent, $ per barrel	79.5	111.3	111.6	108.7	110	110
Exchange rate						
$ per euro	1.327	1.392	1.286	1.328	1.35	1.35

Source: WIFO. 2014, 2015: forecast. – [1] Poland, Slovakia, Slovenia, Czech Republic, Hungary. – [3] Real import growth of trading partners weighted by Austrian export shares. – [3] Dollar.

Growth in Japan is largely shaped this year by fiscal policy measures. The increase in the VAT rate as from April 2014 will give rise to large-scale pre-emptive buying in the first quarter, followed by private demand slack in subsequent months. Economic activity will be sustained by a fiscal stimulus package designed to smooth the impact of the tax hike, as well as by the expansionary stance of monetary policy. Wage negotiations in the current spring should, from the government's perspective, help to foster private incomes and to put a definitive end to deflation. After the strong currency depreciation last year and with energy imports falling after the reconnection of nuclear power plants, foreign trade will also give support to activity. Real GDP is expected to rise by 1.4 percent in 2014 and slow down to 1.2 percent in 2015.

2. Uneven developments in the emerging market economies

Whereas in late 2013 activity rebounded in the rising Asian economies, several countries in Latin America are suffering from the fall in commodity prices and capital outflows.

Expectations for the emerging market economies have clouded recently. In some Asian and Latin American countries, capital outflows and currency depreciations have compelled the authorities to raise interest rates, which is now bearing down on domestic demand. In addition, the fall in raw material prices is dampening business activity, notably in the commodity-exporting countries of Latin America and in Russia.

China's economy, on the other hand, is set to continue growing rapidly (2014 +7.6 percent, 2015 +7.3 percent). Yet, the overheating real estate sector constitutes an important risk. Easy credit conditions offered mainly by a network of shadow banks may give rise to a major increase in bad debt. This would have a destabilising effect on the financial system which could complicate the transformation of the economy from investment- and export-driven expansion towards more consumption-led growth.

In a medium-term perspective, the emerging market economies will grow at a slower pace than over the last years. The catching-up potential has narrowed worldwide, as the competitive advantage of low wage cost has faded in many regions. The transition towards innovation-based growth is bound to be much more difficult than playing the role of an "extended workbench". Moreover, some countries are now facing constraints in their institutional and infrastructure settings, which inhibits further economic expansion. However, despite overall slowdown, the emerging market economies will continue to enjoy growth rates above the global average.

3. Financing problems holding back the catching up of east-central Europe

The swift catching up of the economies in east-central Europe towards the most advanced EU member countries required sizeable inflows of foreign capital. The loss of confidence on the part of investors in the course of the financial market crisis and the deep recession has severely squeezed the available financial resources since 2008.

The loss of confidence on the part of investors since 2008 in the wake of the financial market crisis hit primarily the fast-growing economies in east-central Europe which are highly dependent on the inflow of foreign capital. The drying-up of these capital inflows and high levels of private debt pushed some countries in east-central Europe back into recession in 2012. In 2013, growth returned to the region, and in the five countries of particular importance for the Austrian economy (Poland, Slovakia, Slovenia, Czech Republic and Hungary) it edged up from 0.6 percent in 2012 to almost 1 percent.

The trend at the end of 2013 and recent business surveys indicate a further strengthening of activity during 2014. In the five east-central European countries, growth is expected to accelerate to an annual rate of 2.5 percent in 2014 and almost 3 percent in 2015. The momentum of activity in the region will still fall short of the one observed before the crisis: between 2002 and 2008, annual GDP growth exceeded the euro area average by 3 percentage points, compared with +1½ percentage points since.

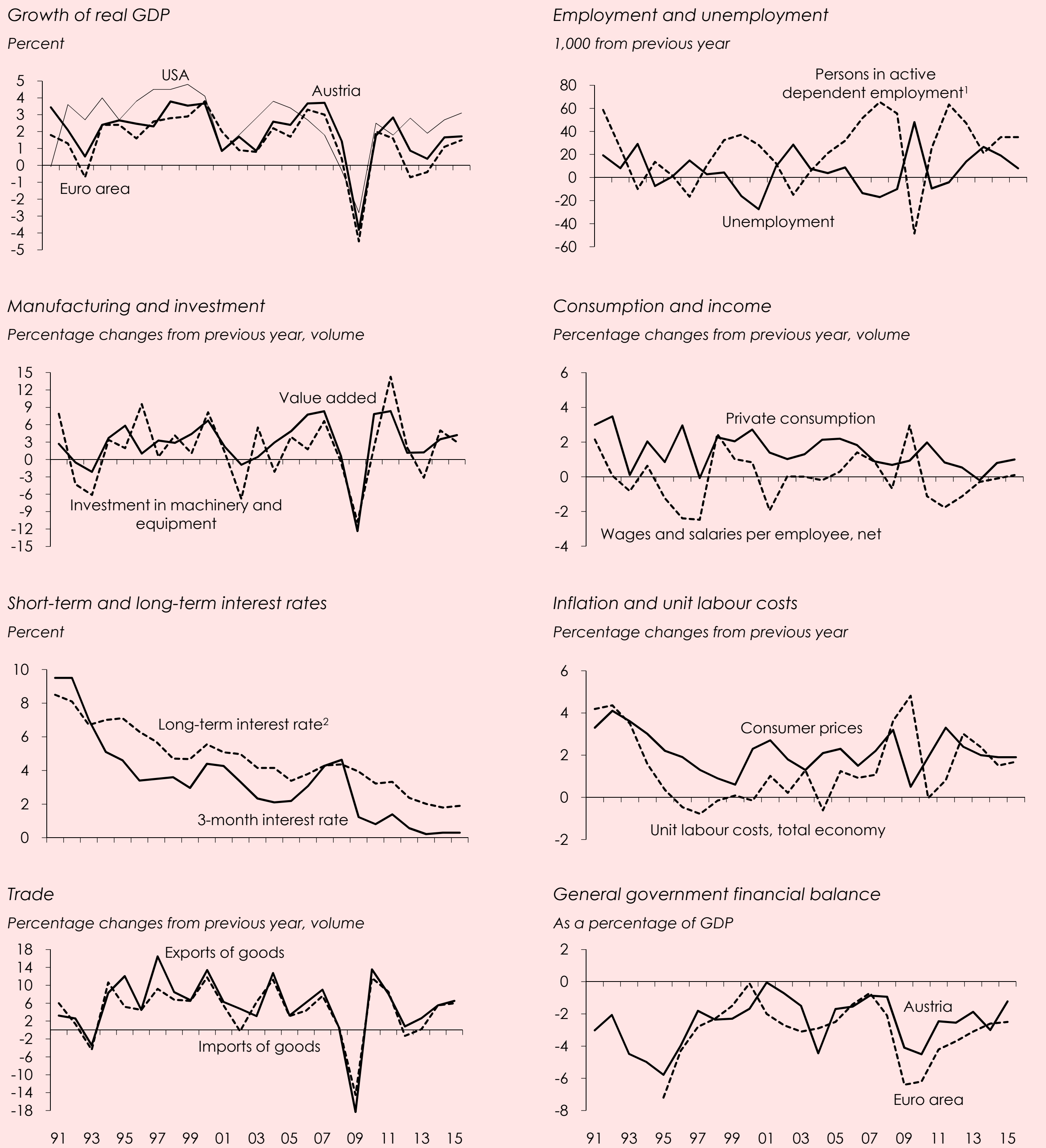
Once private households will benefit from the cyclical recovery via better labour market conditions and be able to reduce their debt levels, financial market confidence will strengthen and give fresh impetus to the catching-up process. In the event, the Austrian economy would be a prime beneficiary.

4. Tentative improvement in the euro area to continue

Although the euro area economy has left the recession behind since the second quarter 2013, the repercussions of the financial market crisis keep weighing on activity. High unemployment is constraining private income and inhibits a speedy reduction of household debt, while consumption remains lacklustre. Companies also still hesitate with investment and hiring. Likewise, the public sector, faced with the need for consolidation, is unable to provide stimulus. Against this background, the recovery from the crisis is unlikely to gather momentum.

GDP in the euro area rose by 0.3 percent in volume in the fourth quarter 2013, no more than in the second quarter. While business surveys suggest a steady improvement, the typical acceleration of growth in a cyclical upswing is not in sight. Nevertheless, the recovery is spreading from a few fore-runners to more and more countries.

Figure 1: Indicators of economic performance



Source: WIFO. 2013, 2014, 2015: forecast. – [1] Excluding parental leave, military service, and unemployed persons in training. – [2] 10-year central government bonds (benchmark).

Given this lack of dynamism of activity, the positive reaction of the labour market is limited. The EU-wide harmonised unemployment rate for the euro area edged down from 12.1 percent in the second and third quarter 2013 to 12 percent in the last three months of the year. While unemployment is meanwhile receding also in Portugal, Spain and Ireland, progress is hardly visible in Italy or Greece.

Sluggish demand growth in the euro area based on the weakness of economic activity is reflected by price developments: headline inflation has followed a downward trend since the middle of 2013 and stood at 0.8 percent in January and 0.7 percent in February 2014. Beyond the fall in world market commodity prices, disinflation mirrors the cyclical sluggishness in many countries. Cyprus and Greece have entered deflation, with consumer prices falling for the last couple of months. Prices in Ireland, Spain and Portugal have been flat on average for some time, since the start of the year also in Slovakia and Slovenia.

Since the end of the long stagnation that followed the Great Recession, the euro area economy has gradually picked up since the second quarter 2013. Demand and output are gaining strength, though less so far than in earlier periods of cyclical upswing. Business surveys do not point to an acceleration of activity in the medium run.

Growing consumer and business confidence is supporting the recovery in the euro area, although the momentum should remain weaker for still some time than in a typical cyclical upswing. After the fall in GDP by 0.7 percent in 2012 and by 0.4 percent in 2013, WIFO expects growth to resume to slightly over 1 percent in 2014, strengthening to 1.5 percent in 2015.

The labour market situation will also improve but slowly. Private household debt will therefore be reduced only tentatively, before consumer demand can pick up. With capacity utilisation rising and output expectations turning more optimistic in the euro area, corporate investment is expected to rebound already in the current year. The momentum will however remain subdued as deleveraging and balance sheet restructuring on the part of banks, companies and private households are still ongoing. Fiscal policy, for its part, is likely to turn somewhat less restrictive over the forecast period than during the last years, despite ambitious plans for government debt reduction.

5. Activity in Austria remaining on a gently rising trend

Since the stagnation in spring 2013, overall output in Austria has been steadily rising (in the fourth quarter 2013 by 0.3 percent from the previous period). Both the WIFO Business Cycle Survey and the WIFO Leading Indicator point towards sustained recovery. Like elsewhere, however, activity is unlikely to gain momentum as one would expect from a cyclical upswing.

Responses in the regular WIFO Business Cycle Survey give no indication of the cyclical upswing gaining pace. Private consumption remains sluggish.

Table 3: Private consumption, income and prices

	2010	2011	2012	2013	2014	2015
	Percentage changes from previous year					
Private consumption expenditure	+ 2.0	+ 0.8	+ 0.5	− 0.2	+ 0.8	+ 1.0
Durables	+ 1.6	+ 1.8	+ 0.6	− 2.2	+ 2.5	+ 1.0
Non-durables and services	+ 2.0	+ 0.7	+ 0.5	+ 0.0	+ 0.6	+ 1.0
Household disposable income	− 0.5	− 1.3	+ 1.1	− 1.2	+ 1.1	+ 1.3
	As a percentage of disposable income					
Household saving ratio[1]	8.9	6.7	7.4	6.5	6.8	7.1
Household saving ratio[2]	8.4	6.4	7.0	6.0	6.3	6.6
	Percentage changes from previous year					
Direct lending to domestic non-banks[3]	+ 2.9	+ 2.7	+ 0.0	− 1.2	+ 1.8	+ 2.3
	Percentage changes from previous year					
Inflation rate						
National	1.9	3.3	2.4	2.0	1.9	1.9
Harmonised	1.7	3.6	2.6	2.1	1.9	1.9
Core inflation[4]	1.2	2.8	2.3	2.3	2.1	1.9

Source: WIFO. 2014, 2015: forecast. – [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.

Private consumption is set to stay anemic over the forecast period. Having edged down by 0.2 percent in volume in 2013, household demand is projected to gain a modest 0.8 percent in 2014, despite the expected advance purchases of motor cars in view of the hike in the registration tax for new cars. In 2015, consumption growth is likely to strengthen to +1.0 percent. Due to sluggish income growth, private consumption will not provide support to business activity. Real net wages per capita will decline in 2014 for the fifth consecutive year, before tentatively heading up by 0.1 percent in 2015.

Private households are likely to further increase spending at the expense of saving. In 2013, the saving ratio fell to 6.5 percent of disposable income, the lowest reading since the establishment of a consistent time series in 1995. For 2014 and 2015, the ratio is projected to climb to 6.8 percent and 7.1 percent respectively.

The expected increase in gross fixed investment by an inflation-adjusted 3 percent in 2014, following the setback of almost 1 percent in 2013, is only partly a sign of cyclical revival as it also reflects the liquidation of pent-up demand for replacement of machinery and equipment. In 2015, investment growth is likely to abate to 2 percent in real terms, bringing it more closely in line with the muted overall cyclical dynamics.

Corporate spending on new machinery and equipment will perform better in 2014 and 2015 than construction investment suffering from restraint in public orders as part of fiscal consolidation efforts. Yet, given the high import content of demand for business equipment, domestic production will not benefit to full extent from the rebound.

Net exports will provide only limited stimulus to domestic GDP growth over the forecast horizon. While demand and output will pick up both in the EU overall and in the euro area, the momentum will fall short of a "normal" cyclical upturn. Growth in the emerging market economies will also be less vigorous than in the past, leaving only the US economy as strongly-performing trading partner.

Given this environment, exports of goods are projected to expand by 5.5 percent in volume in 2014, at the same rate as merchandise imports. The external contribution to GDP growth will thus turn out smaller than in 2013. Only by 2015, growth of merchandise exports should again exceed that of imports.

Table 4: Earnings and international competitiveness

	2010	2011	2012	2013	2014	2015
	Percentage changes from previous year					
Gross earnings per employee[1]	+ 0.9	+ 1.8	+ 2.4	+ 2.1	+ 2.1	+ 2.4
Gross real earnings per employee[2]	– 0.9	– 1.4	– 0.1	+ 0.1	+ 0.2	+ 0.5
Net real earnings per employee[2]	– 1.1	– 1.8	– 1.1	– 0.3	– 0.1	+ 0.1
Unit labour costs						
Total economy	– 0.0	+ 0.8	+ 3.0	+ 2.4	+ 1.5	+ 1.7
Manufacturing	– 6.9	– 3.0	+ 3.0	+ 2.0	– 0.8	– 1.0
Effective exchange rate, manufactures						
Nominal	– 2.9	+ 0.1	– 1.7	+ 1.8	+ 0.8	+ 0.2
Real	– 3.2	+ 0.5	– 1.7	+ 2.1	+ 1.0	– 0.1

Source: WIFO. 2014, 2015: forecast. – [1] Employees according to National Accounts definition. – [2] Deflated by CPI.

5.1 No danger of deflation in Austria

Headline inflation in Austria remains well above the euro area average. Higher consumption taxes will fuel the rise in consumer prices in 2014 and 2015.

In February 2014, the annual rate of inflation in Austria edged down from 1.6 percent in January to 1.5 percent, largely on account of the fall in fuel prices which accelerated from –3.7 percent in January to –5.3 percent in February. Like in the last few months, food prices, but also prices in the category "restaurants and hotels" (+2.9 percent) and housing rents (+3 percent) provided major upward pressure.

For the whole year 2014, WIFO projects headline inflation at 1.9 percent. The dampening impact of lower fuel prices is set to fade over the remainder of the year, while the hikes of the tobacco tax, the car insurance tax (based on the engine size), the car registration tax, the taxes on alcoholic beverages and on sparkling wine as from 1 March 2014 will push the price index up by around ¼ percentage point on annual average. The same inflation rate of 1.9 percent is expected for 2015, whereby almost 0.2 percentage points will derive from a further increase in the tobacco tax on

1 April 2015 and the adjustment of benchmark housing rents in the first half of 2014 that will show up in the consumer price index with a delay of around six months.

Thus, no tendencies of deflation are in sight over the forecast horizon. Indeed, Austria's rate of inflation keeps exceeding the euro area average: in February 2014, consumer prices in Austria rose by 1.5 percent year-on-year, compared with +0.7 percent in the euro area; the difference of 0.8 percentage points is largely attributable to prices of services (hotels, cafés and restaurants +0.3 percentage points, telecommunication +0.2 percentage points, cultural and leisure services as well as health services in hospital +0.1 percentage point each). Rents also climbed faster than in the euro area on average (Austria +3 percent, euro area +1.4 percent).

Table 5: Productivity

	2010	2011	2012	2013	2014	2015
		Percentage changes from previous year				
Total economy						
Real GDP	+ 1.8	+ 2.8	+ 0.9	+ 0.3	+ 1.7	+ 1.7
Hours worked[1]						
Productivity per hour	+ 0.7	+ 1.8	+ 1.4	+ 0.6	+ 0.8	+ 0.9
Employment[2]	+ 1.0	+ 1.0	− 0.5	− 0.3	+ 0.8	+ 0.9
Manufacturing						
Production[3]	+ 7.8	+ 8.3	+ 1.2	+ 0.8	+ 3.5	+ 4.2
Hours worked[1]	− 1.3	+ 1.9	+ 1.7	± 0.0	+ 0.1	+ 0.3
Productivity per hour	+ 6.0	+ 6.4	+ 0.1	+ 0.9	+ 3.0	+ 3.9
Employees[1]	+ 3.0	− 0.1	− 0.6	− 0.1	+ 0.4	± 0.0

Source: WIFO. 2014, 2015: forecast. – [1] According to National Accounts definition. – [2] Dependent and self-employed according to National Accounts definition. – [3] Value added, volume.

Table 6: Labour market

		2010	2011	2012	2013	2014	2015
			Changes from previous year, in 1,000				
Demand for labour							
Persons in active employment[1]		+ 37.4	+ 67.3	+ 51.7	+ 30.3	+ 41.0	+ 40.0
Employees[2]		+ 25.5	+ 63.3	+ 47.2	+ 21.2	+ 35.0	+ 35.0
Percentage changes from previous year		+ 0.8	+ 1.9	+ 1.4	+ 0.6	+ 1.0	+ 1.0
Nationals		+ 5.8	+ 25.7	+ 9.0	− 8.5	+ 3.0	+ 9.0
Foreign workers		+ 19.7	+ 37.7	+ 38.1	+ 29.7	+ 32.0	+ 26.0
Self-employed[3]		+ 11.9	+ 4.0	+ 4.5	+ 9.1	+ 6.0	+ 5.0
Labour supply							
Population of working age	15 to 64 years	+ 17.3	+ 31.3	+ 18.0	+ 14.0	+ 5.8	+ 8.1
	15 to 59 years	+ 4.9	+ 11.7	+ 22.3	+ 18.0	+ 5.6	+ 1.7
Labour force[4]		+ 27.9	+ 63.2	+ 65.6	+ 56.9	+ 60.0	+ 48.0
Surplus of labour							
Registered unemployed[5]		− 9.5	− 4.1	+ 13.9	+ 26.6	+ 19.0	+ 8.0
In 1,000		250.8	246.7	260.6	287.2	306.2	314.2
Unemployed persons in training[5]	in 1,000	73.2	63.2	66.6	73.5	79.5	82.5
			In percent				
Unemployment rate							
Eurostat definition[6]		4.4	4.2	4.3	4.9	5.2	5.3
As a percentage of total labour force[5]		6.2	6.0	6.3	6.8	7.2	7.3
National definition[5,7]		6.9	6.7	7.0	7.6	8.0	8.1
Employment rate							
Persons in active employment[1,8]		65.4	66.2	66.9	67.3	68.0	68.6
Total employment[6,8]		71.7	72.1	72.5	72.4	72.7	73.0

Source: WIFO. 2014, 2015: forecast. – [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).

5.2 Supply of labour rising faster than demand

The cyclical recovery in Austria goes along with a pickup in employment growth. In the last few months, also the number of hired personnel has been rising markedly.

After an increase by 0.6 percent in 2013, the number of persons in dependent active employment is expected to go up by 35,000 or 1 percent each in 2014 and 2015.

The gradual cyclical recovery goes hand in hand with an increase in employment. However, job creation does not keep pace with growing labour supply, leading to a further rise in unemployment.

The improving business outlook, together with free access to the Austrian labour market being granted from 1 January 2014 onwards for workers from Bulgaria and Romania, adds to the growth of labour supply from abroad. The domestic labour force, for its part, is boosted by new restrictions on access to early retirement benefits. Since GDP growth in 2014 and 2015 will not be strong enough as to fully absorb the additional labour supply, unemployment is set to keep rising in both years. In 2014, the number of registered unemployed is projected to reach a total of around 306,000 (+19,000), in 2015 of 314,000. The jobless rate, according to national definition, will ratchet up from 7.6 percent of the dependent labour force in 2013 to 8.0 percent in 2014 and 8.1 percent in 2015.

6. Government balance shaped by consolidation measures and support for Hypo Alpe-Adria-Bank

In 2014 and 2015, the general government balance (Maastricht definition) will be shaped by further measures of fiscal consolidation and financial aid for the resolution of Hypo Alpe-Adria-Bank AG through a Bad Bank. For 2014, WIFO projects the general government deficit to rebound to 3.0 percent of nominal GDP. The deterioration of the balance by about 1 percentage point from the last forecast revision of December 2013 is mainly the result of higher capital transfers required for the resolution of Hypo Alpe-Adria-Bank AG. The Tax Amendment Act ("Abgabenänderungsgesetz") recently promulgated provides for additional tax revenues to the tune of over € 0.7 billion for 2014 and for more than € 1.1 billion in 2015.

Like in the forecast of last December, WIFO assumes that a consolidation amount of € 2 billion in structural terms will be achieved in 2014 (of which € 1 billion stemming from higher taxes) and € 1 billion in 2015. On the expenditure side, a cut of federal discretionary spending by € 0.5 billion has been agreed so far. The forecast also includes the cost of the increase in family allowances by 4 percent as from July 2014 and the reimbursement of dental braces from 2015.

While the consolidation measures will affect also the structural government balance, the moves for the resolution of Hypo Alpe-Adria-Bank AG have no direct structural effect. As the key variable of discretionary fiscal action, the structural government balance is equal to the nominal balance in the Maastricht definition, adjusted for cyclical variations and one-off effects. Capital transfers to distressed banks that had to be nationalised like Hypo Alpe-Adria-Bank AG are classified as one-off payments. One-off revenues to a significant amount (around € 0.5 billion) will accrue in 2014 from the tax agreement with Liechtenstein.

On the basis of the information publicly available at present, the forecast assumes that the federal government will set up a Bad Bank in 2014 which will take over around € 18 billion in liabilities from Hypo Alpe-Adria-Bank AG. This amount will raise directly and to full extent the level of public debt in 2014. It is assumed that the resolution of Hypo Alpe-Adria-Bank AG will burden the general government balance in the Maastricht definition for 2014 by € 4 billion, up by € 3 billion from the assumption underlying the forecast of last December. This amount includes the capital transfers required for the setting up of the Bank's balance sheet for 2013, and the depreciation of assets of Hypo Alpe-Adria-Bank AG to be realised in the course of the establishment of the Bad Bank. In the forecast of last December, WIFO assumed capital transfers to Hypo Alpe-Adria-Bank AG of € 1.5 billion for 2015. If the Bad Bank is set up in 2014, such capital transfers will no longer be necessary in 2015, which will reduce the Maastricht deficit vis-à-vis the figure retained in the forecast of last December. The government borrowing required in order to cover the losses of Hypo Alpe-Adria-Bank AG will lead to higher interest payments in future years, which will also impact on the structural deficit.

For 2015, WIFO anticipates a general government deficit of 1.2 percent of GDP. The improvement by 0.4 percentage points from the forecast of last December is explained by lower capital transfers to nationalised banks in distress which will more than offset the higher federal government interest payments due in the context of the establishment of the Bad Bank for Hypo Alpe-Adria-Bank AG. The structural deficit for 2015 is projected at 0.9 percent of GDP. The government debt ratio will rise slightly above 80 percent of GDP in 2014, but drop back below that mark in the subsequent year.

The budget projection is fraught with considerable risk and uncertainty. In the event of the inferred consolidation measures not being implemented to full extent, the deficits for 2014 and 2015 would turn out higher accordingly. Moreover, on the expenditure side, the financial needs of Hypo Alpe-Adria-Bank AG, but also of the other nationalised banks in distress, may come to exceed the amount assumed here.

Table 7: Key policy indicators

	2010	2011	2012	2013	2014	2015
	As a percentage of GDP					
Fiscal policy						
General government financial balance						
According to Maastricht definition	− 4.5	− 2.5	− 2.5	− 1.9	− 3.0	− 1.2
Structural budget balance	− 3.2	− 2.4	− 1.8	− 1.7	− 1.3	− 0.9
General government primary balance	− 1.8	+ 0.2	+ 0.1	+ 0.7	− 0.6	+ 1.2
	In percent					
Monetary policy						
3-month interest rate	0.8	1.4	0.6	0.2	0.3	0.3
Long-term interest rate[2]	3.2	3.3	2.4	2.0	1.8	1.9
	Percentage changes from previous year					
Effective exchange rate						
Nominal	− 2.7	+ 0.2	− 1.5	+ 1.7	+ 0.8	+ 0.2
Real	− 3.0	+ 0.6	− 1.6	+ 2.0	+ 1.0	− 0.1

Source: WIFO. 2014, 2015: forecast. – [1] 10-year central government bonds (benchmark).

7. Main risks to the forecast: emerging markets, Ukraine crisis and deflation

Further drain of capital from the emerging market economies may cause serious currency turbulence. The danger of deflation should subside for the euro area overall, though remaining virulent for certain countries. The tensions between Russia and Ukraine and potential sanctions constitute a further element of uncertainty in the present forecast.

The greatest risk factor for global business activity is currently the outlook for capital markets in the rising economies. Although exchange rates have stabilised after the bout of devaluations in January 2014, a new wave of capital outflows cannot be ruled out. The announcement of a turnaround in US monetary policy, which in 2013 unsettled capital markets, should meanwhile have been largely absorbed into portfolio decisions. Yet, several emerging markets still struggle with high current account deficits and heavy foreign-currency debt which keeps them vulnerable to abrupt capital drain. Single events like the crisis in Ukraine may trigger renewed capital outflows or currency turbulence. In the event, the countries concerned would be compelled to raise interest rates once again in order to stem capital flight, with adverse implications for business activity. The related uncertainty would also hold back the economic recovery worldwide.

Table 8: Foreign trade with Russia 2013

	Million €	Percentage changes from previous year	Pecentage shares of total exports/imports
Exports to Russia			
EU 28	119,763	− 2.9	2.6
Euro area 18	88,581	− 4.0	2.5
Austria	3,477	+ 9.2	2.8
Imports from Russia			
EU 28	206,581	− 3.9	4.6
Euro area 18	145,549	+ 0.2	4.4
Austria	3,183	− 22.2	2.4

Source: Eurostat, Statistics Austria.

The conflict between Russia and Ukraine had so far economic repercussions limited to the region. While economic relations of the EU overall, the euro area and Austria with Ukraine are of minor importance, those with Russia are much more substantial: about 2½ percent of total EU and euro area exports go to Russia (Table 8; the bulk being machinery and vehicles), and some 4½ percent of imports are received from Russia. Hence, Russia is running a considerable trade surplus with both areas. For Austria's exports, Russia is somewhat more important, with a share of about 3 percent of the total, but only 2.4 percent of imports are supplied by Russia (mainly fuels). As a target for direct investment, Russia plays a minor role for the EU as a whole and for the euro area (Table 9; around 1.5 percent of the total stock of EU or euro area foreign direct investment is located in Russia, only ¾ percent of Russia's foreign direct investment has been placed in the EU or the euro area). Austria's investment ties with Russia are again closer, with shares of some 5 percent respectively of outward- and inward-bound foreign investment.

Table 9: Foreign direct investment (FDI) in and by Russia 2012

	Million €	Percentage changes from previous year	Percentage shares of total investment
FDI stock in Russia			
EU 28	189,518	+ 11.9	1.5
Euro area 18	173,312	+ 15.3	1.7
Austria	8,494	+ 6.7	5.3
FDI stock from Russia			
EU 28	76,749	+ 33.8	0.7
Euro area 18	71,775	+ 34.7	0.8
Austria	6,535	+ 17.9	5.2

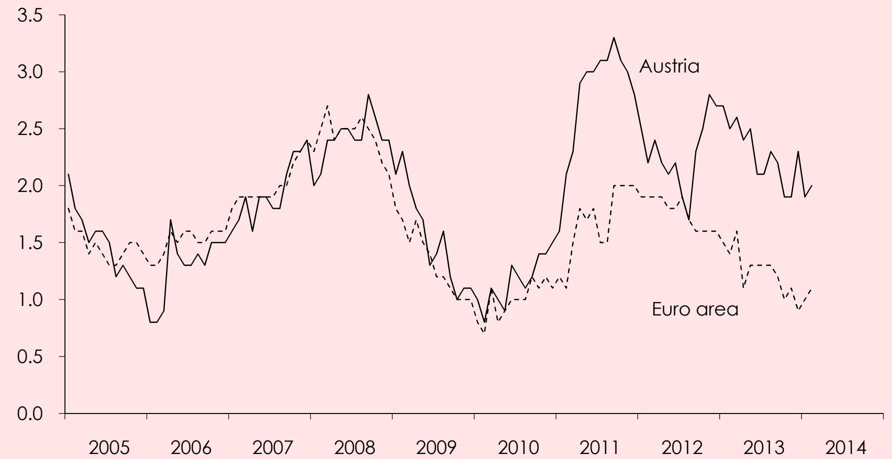
Source: Eurostat.

Should large-scale economic sanctions be imposed, they may affect foreign trade and foreign direct investment. As such measures have not yet been specified, they have not been built into the assumptions of the present forecast.

A further downward cyclical risk lies in the danger of deflation in the euro area. In most EU countries and in the euro area overall, inflation decelerated steadily in 2012 and 2013. The downward trend mirrors, on the one hand, the fading of temporary factors like indirect tax increases in the context of fiscal consolidation or price hikes for food and energy; on the other hand, the cyclical sluggishness is keeping a lid on inflation.

Figure 2: Core inflation in Austria and the euro area

Percentage changes from previous year



Source: Eurostat.

An actual fall in the overall price level would constitute a further obstacle to the slow cyclical recovery of the euro area. It is tantamount to an increase in real interest rates and in the real value of debt. Both elements would constrain growth of private consumption and of corporate investment which in turn may dampen prices and wages, setting in motion a self-reinforcing "spiral" of deflation.

More telling of the underlying price trend than the overall figure is the rate of core inflation which abstracts from the volatile prices for unprocessed food and energy (Figure 2). Core inflation in Austria was below 1 percent in early 2010 after the deep recession, significantly lower than the roughly 2 percent recorded during the last months. In the euro area, the core inflation rate of currently around 1 percent is barely above the trough of January 2010; the nascent recovery may soon lead to a pick-up. Thus, in the euro area overall there seems to be no danger of deflation. However, in a number of euro-area countries, the inflation rate is only slightly positive or has fallen below zero, notably in the crisis countries in southern Europe. Should these countries slip into an extended period of deflation, it would give rise to political and social tensions and reinforce the drifting-apart between the members of Monetary Union.

The financial sector of the euro area also faces a number of challenges in 2014. In the run-up to the implementation of supervision of the major banks by the European Central Bank, comprehensive stress tests will be carried out during summer and autumn 2014 in order to identify banks' capital requirements. Should it become evident that some banks have to rely on financial support from public authorities, putting further strain on government budgets, it may lead to a relapse in confidence of private households, companies and financial investors.