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First Increase in Private Consumption in Three Years

Economic Outlook for 2016 and 2017

First Increase in Private Consumption in Three Years. Economic Outlook for 2016 and 2017
Total production in Austria should grow in real terms by 1.7 percent in 2016, significantly above the pace recorded for the last four years and closing the growth gap vis-à-vis Germany and the euro area average. While the contribution of net trade is dragging down growth this year, domestic demand is rising substantially. Investment is lively and private households, for the first time in three years, are spending in real terms more on consumption. In 2017, stronger exports should offset some slackening in internal demand, keeping real GDP growth at 1.5 percent.

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For the first time in three years, private consumption is set to increase in 2016, providing with an expected rate of +1.5 percent in real terms a major impulse to GDP growth. Major drivers of demand are the tax reform and the wave of immigration; with both factors abating in 2017, consumption growth is likely to slow down to +1.2 percent.

Private investment had strengthened already in 2015, notably purchases of machinery and equipment. Despite subdued business expectations, the momentum was unabated in the first half of 2016, suggesting that firms' main motives are the replacement of obsolete production equipment rather than capacity-expanding capital formation.

Construction activity also seems to have passed its trough in late 2015 and remained upward bound in the first half of 2016, benefitting also from favourable weather conditions in the first quarter. The positive trend was confined to the building sector, in particular the non-residential construction. Also residential construction has expanded, even if the latest government initiatives have not yet been implemented. Activity in civil engineering has remained sluggish so far. Construction investment overall is projected to gain 1.6 percent in volume in 2016 and 1.4 percent in 2017.

The weakness of global business conditions is weighing on domestic activity in 2016. GDP growth in the USA has been trailing that of the EU since autumn 2015. The economic situation remains fragile also in the emerging markets, but some early signs point to an imminent recovery. Austrian exports are likely to expand by only 2.8 percent in real terms in the current year, after +3.6 percent in 2015. The momentum will remain at a moderate +2.8 percent also in 2017, given that export market growth will be no higher than in 2015 (2016 +2.7 percent, 2017 +3.0 percent). The outcome of the Brexit referendum in the UK has undermined market confidence only for a short while; the present forecast expects little overall impact on business activity in Austria, which would show up in 2017 rather than in 2016.

Inflation remains at a very low 1 percent in 2016, although significantly exceeding the euro area average. Oil prices are assumed to rebound in 2017 from their retreat during the last few years, driving headline inflation up to an annual average 1.7 percent.

Table 1: Main results

		2012	2013	2014	2015	2016	2017
		Percentage changes from previous year					
GDP							
Volume		+ 0.7	+ 0.1	+ 0.6	+ 1.0	+ 1.7	+ 1.5
Value		+ 2.7	+ 1.7	+ 2.4	+ 2.9	+ 3.6	+ 3.1
Manufacturing[1], volume		+ 2.3	+ 0.3	+ 1.5	+ 1.5	+ 2.5	+ 2.3
Wholesale and retail trade, volume		− 1.6	− 2.1	+ 2.0	+ 0.6	+ 2.5	+ 2.3
Private consumption expenditure, volume		+ 0.5	− 0.1	− 0.3	− 0.0	+ 1.5	+ 1.2
Gross fixed investment, volume		+ 1.4	+ 2.2	− 0.9	+ 0.7	+ 3.4	+ 2.3
Machinery and equipment[2]		+ 0.6	+ 2.4	− 1.0	+ 3.6	+ 5.0	+ 3.0
Construction		+ 2.2	− 0.9	− 0.1	− 1.2	+ 1.6	+ 1.4
Other investment[3]		+ 0.6	+ 9.2	− 2.4	+ 0.6	+ 4.7	+ 3.0
Exports of goods[4]							
Volume		+ 0.5	+ 2.8	+ 2.7	+ 3.7	+ 2.8	+ 3.0
Value		+ 1.5	+ 1.8	+ 1.8	+ 2.7	+ 1.7	+ 3.8
Imports of goods[4]							
Volume		− 0.9	− 0.2	+ 0.7	+ 5.7	+ 4.5	+ 3.0
Value		+ 0.7	− 1.0	− 0.7	+ 2.8	+ 1.9	+ 4.5
Current balance	billion €	+ 4.73	+ 6.29	+ 6.38	+ 8.64	+ 9.82	+ 9.47
As a percentage of GDP		+ 1.5	+ 2.0	+ 1.9	+ 2.5	+ 2.8	+ 2.6
Long-term interest rate[5]	percent	2.4	2.0	1.5	0.7	0.3	0.3
Consumer prices		+ 2.4	+ 2.0	+ 1.7	+ 0.9	+ 1.0	+ 1.7
Unemployment rate							
Eurostat definition[6]	percent	4.9	5.4	5.6	5.7	6.0	6.1
National definition[7]	percent	7.0	7.6	8.4	9.1	9.2	9.4
Persons in active dependent employment[8]		+ 1.4	+ 0.6	+ 0.7	+ 1.0	+ 1.4	+ 1.1
General government financial balance according to Maastricht definition							
As a percentage of GDP		− 2.2	− 1.4	− 2.7	− 1.0	− 1.6	− 1.5

Source: WIFO. 2016 to 2017: forecast. – [1] Value added, including mining and quarrying. – [2] Including weapon systems. – [3] Intellectual property products and cultivated biological resources. – [4] According to Statistics Austria. – [5] 10-year central government bonds (benchmark). – [6] According to Eurostat Labour Force Survey. – [7] According to Public Employment Service Austria, as a percentage of total labour force excluding self employed. – [8] Excluding persons with valid employment contract receiving child care benefit or being in military service.

The forecasted pick-up in GDP growth will keep overall employment in Austria on an upward trend. The number of persons in active dependent employment is rising by 1.4 percent in the current year (after +1 percent in 2015) and by over 1 percent again in 2017. Still, the momentum of job creation will not keep pace with labour supply growth, even if unemployment should rise less than in recent years. The rate of unemployment, on national definitions, will ratchet up marginally from 9.1 percent last year to 9.2 percent in 2016 and 9.4 percent in 2017.

1. Weaker activity in the USA, recovery in the emerging markets

In regions outside the EU, economic activity was particularly weak in late 2015 and early 2016. Demand and output in the USA slackened markedly as from the fourth quarter 2015 and until mid-2016, while the emerging market countries keep facing difficult challenges. Against this background, world trade slowed down significantly and will, according to the CPB Index, rise by only 0.5 percent this year, the smallest gain since the crisis of 2008-09.

The US economy is experiencing a period of weakness: in the fourth quarter 2015 and the first three months of 2016, real GDP edged up by only 0.2 percent quarter-on-quarter, respectively, followed by +0.3 percent in the second quarter 2016. Since autumn 2015, US growth has thereby fallen behind that of the EU.

The fall in private demand for machinery and equipment and residential building came as a major drag on economic activity. Moreover, the second quarter 2016 saw a significant reduction of inventories, such that rising demand could not translate into higher production.

Private consumption, on the other hand, proved resilient, benefiting from the rebound in labour demand after the crisis of 2008-09, low inflation and easy financing conditions. Household demand should stay lively in the months to come as consumer confidence remains at a high level.

The current cyclical weakness is reflected by the stagnation of industrial output since the beginning of the year and in the no-longer-declining unemployment rate. The monetary authorities have so far kept the key interest rate at the extremely low 0.25 to 0.5 percent. Consumer price inflation stood at 1.1 percent in August.

Table 2: World economy

	2012	2013	2014	2015	2016	2017
	Percentage changes from previous year					
Real GDP						
World	+ 3.5	+ 3.3	+ 3.4	+ 3.1	+ 3.0	+ 3.3
USA	+ 2.2	+ 1.7	+ 2.4	+ 2.6	+ 1.5	+ 2.2
Japan	+ 1.7	+ 1.4	– 0.0	+ 0.5	+ 0.5	+ 0.5
EU	– 0.5	+ 0.2	+ 1.5	+ 2.2	+ 1.8	+ 1.6
Euro area	– 0.9	– 0.3	+ 1.1	+ 2.0	+ 1.6	+ 1.5
CEEC 5[1]	+ 0.4	+ 0.9	+ 3.0	+ 3.6	+ 2.4	+ 2.8
China	+ 7.7	+ 7.7	+ 7.3	+ 6.9	+ 6.4	+ 6.2
World trade, volume	+ 1.6	+ 2.6	+ 2.8	+ 1.5	+ 0.5	+ 2.0
Market growth[2]	+ 0.6	+ 1.8	+ 3.5	+ 3.0	+ 2.7	+ 3.0
Crude oil prices						
Brent, $ per barrel	111.6	108.7	99.0	52.5	45	57
Exchange rate						
$ per €[3]	1.286	1.328	1.329	1.110	1.10	1.10

Source: WIFO. 2016 to 2017: forecast. – [1] Czech Republic, Hungary, Poland, Slovakia, Slovenia. – [2] Real import growth of goods of trading partners (according to Oxford Economics) weighted by Austrian export shares. – [3] Annual averages on the basis of monthly averages.

The present forecast assumes that the US economy will regain momentum that will extend into 2017, without though accelerating further. Annual GDP growth would thus move from 1.5 percent in 2016 to 2.2 percent in 2017.

China's economy has picked up since the middle of 2016 under the impact of comprehensive policy stimulation measures. The rebound is witnessed by rising industrial production and higher raw material imports, as well as by the leading business cycle indicators. The situation has also improved for the commodity-exporting emerging market countries. While Russia still suffers from low commodity prices and the political sanctions, the past strong fall in GDP should give way to a gradual recovery. The OECD Leading Indicators also point to an imminent cyclical revival for Brazil.

2. Cyclical recovery in the EU losing steam

EU GDP rose by an inflation-adjusted 0.5 percent quarter-on-quarter in the first quarter 2016, the same rate as in the earlier period. During the following three months, growth slowed only marginally to 0.4 percent.

In late 2015 and early 2016, internal demand acted as a stabiliser of business activity in the euro area as well as in the EU at large, while external sluggishness weighed on output growth. In the second quarter, demand forces shifted in favour of the external side. Improving labour market conditions in the EU bode well for sustained private consumption growth. Overall EU employment gained 0.4 percent from the previous quarter (euro area +0.3 percent) and +1.5 percent (euro area +1.4 percent) from the year-earlier period. The euro area unemployment rate of around 10 percent remains high by international standards, though following a downward trend in the last few years.

The outcome of the UK referendum in favour of exit from the EU has only temporarily dented business and consumer sentiment. The result will dampen economic growth in the UK, but hardly in the other EU member countries.

The impact of the UK vote to exit from the EU on the business cycle

In a referendum held last June, a majority of British voters opted against their country staying within the EU. Although the vote does not legally bind the UK government and the latter has so far not submitted a formal exit request to the European Commission, the outcome of the referendum has unsettled market participants at a critical juncture of the business cycle.

The consequences of a possible Brexit for the Austrian economy have so far hardly been analysed. International studies expect rather limited long-term effects for the EU as a whole, without specifying any details for Austria. With a share of some 3 percent of commodity exports, the UK claims rank eight in Austria's major foreign markets. Austria mainly supplies the UK with machine tools and components for motor car production. The direct market share, however, underestimates the role of the bilateral goods exchange since deliveries from third countries to the UK often contain Austrian inputs and value added. The world input-output model shows an Austrian value-added share of only 0.9 percent for Germany's exports to the UK, again suggesting rather small overall effects of Brexit.

The Ifo Institute estimates long-term losses for Austria of no more than 0.05 to 0.18 percent of GDP per capita, depending on the scenario; potential positive effects, such as deeper integration within the remaining EU or relocation of production back to Austria, have not been taken into account.

Apart from the long-run repercussions of Brexit[1], the short-term cyclical effects are also of interest. Thus, Sterling has lost about 10 percent vis-à-vis the Euro since the referendum of 23 June, which makes UK imports from the euro area more expensive and weighs on Austrian exports. Uncertainty about the exit procedure is also undermining the investment climate, possibly triggering a recession in the UK, from which trading partners would suffer as well.

The vote in favour of Brexit provoked strong volatility on global financial markets and European stock market values retreated across the board, particularly financial titles. Early pledges by central banks worldwide to counter any weakening of the financial market environment by further expansionary measures helped to reassure markets. In August, the Bank of England cut the key interest rate by 25 basis points to 0.25 percent. The UK stock market index FTSE 100 as well as other European share price indices rebounded and meanwhile hold a level well above the one before the referendum. Major sentiment indicators for the UK economy receded in July, but bounced back in August and currently signal no major economic setback.

Since the impact of exchange rate changes manifests itself only with a time-lag, current export data do currently not allow to assess any adverse effects on business activity. More meaningful are model calculations on the basis of past empirical relations. For Germany, the Ifo Institute sees GDP growth reduced at the most by 0.1 percent in 2016 and 0.2 percent in 2017, in the event of a sharp slowdown of growth in the UK, coupled with Sterling depreciation. The DIW in Berlin arrives at output growth losses of 0.1 and 0.3 percentage points for 2016 and 2017 respectively. For Austria, due to the relatively weaker ties with the UK economy, the negative effect consistent with both simulations should be below 0.1 percent of GDP in 2017.

[1] See also the forthcoming WIFO Medium-Term Projection for the world economy (WIFO-Monatsberichte 10/2016).

The noticeable pick-up in investment in the euro area around the turn of the year has not led to a self-sustaining investment cycle, as demand fell back into stagnation in spring. The majority vote for Brexit in the UK referendum unsettled markets further and may undermine the investment climate.

Yet, business surveys for the EU and the euro area do not indicate a sharp fall in confidence. Indeed, the indicator headed up slightly both in July and August, suggesting continued economic growth for the next months. The WIFO forecast expects euro area GDP to increase by 1.6 percent in 2016 and 1.5 percent in 2017.

The inflation rate in the euro area continues to widely undershoot the monetary target rate of close to 2 percent. In July and August, the Harmonised Consumer Price Index exceeded the year-earlier level by only 0.2 percent. The non-conventional monetary policy measures continue to shape developments on European financial markets, as large-scale purchases of government and corporate bonds to the amount of 80 billion € per month push down yields. Government bonds of several EU member countries have for some time carried negative returns, and also money market rates for inter-bank loans are negative. In September, also some large euro-area companies have for the first time been able to issue bonds carrying negative yields.

Although inflation still does not react to ECB policy, the extension of loans to the private sector has recently picked up, usually an early sign for a cyclical upturn. Thus, the volume of credit to private households has been rising since spring 2015 and lending to non-financial enterprises since early 2016. The positive trend has not been confined to a few countries, but can be observed for many EU member countries.

2.1 East-Central European economies growing barely more strongly in 2017

After having enjoyed solid growth of 3.6 percent in 2015, the economies of the CEEC 5 (Poland, Slovakia, Slovenia, Czech Republic and Hungary) slackened in the first three months of 2016. Indeed, GDP stagnated at the level of the previous quarter, the weakest performance since early 2013. Growth resumed in the second quarter (+0.8 percent), though gross fixed investment suffered a further major setback.

For the current year, WIFO expects only moderate growth of close to 2½ percent for the CEEC 5, edging up to 2.8 percent in 2017. Yet, the momentum of demand and output growth in this crucial region for Austria's foreign trade remains significantly weaker than in 2014-15. Next to sluggish activity in the USA, the deceleration in eastern neighbour countries reduces Austria's export opportunities.

3. Growth in Germany losing momentum

The lively expansion of the German economy in early 2016 slackened markedly in spring. Business surveys suggest a further deceleration in the second half of the year.

After a strong +0.7 percent quarter-on-quarter in the first three months of 2016, GDP growth in Germany abated to 0.4 percent in the second quarter. The slowdown was mainly due to internal demand: private and public consumption recorded only modest gains, while investment in machinery and construction receded from the previous period. GDP growth was sustained by higher net exports, despite the subdued external business environment. Exports advanced strongly from the first quarter, whereas imports declined slightly.

The Ifo Business Survey of last September showed an improvement, both in firms' expectations and in judgements of their current situation, following respective declines in the climate index in the two previous months.

The index of industrial production followed a downward trend from the beginning of 2016 until July. The European Commission business confidence indicator for the manufacturing industry of Germany eased also in August, while incoming orders have been flat ever since the beginning of the year.

Developments remain favourable both on the labour market and in government households. The rate of unemployment declined further in July, to a low of 4.2 percent. Current budgetary figures signal another general government surplus for 2016.

4. Growth in Austria sustained by domestic demand forces

While in 2016 domestic consumption and investment in Austria enjoy the strongest expansion in several years, the contribution of net trade is straining growth.

After several years of sluggishness, economic activity in Austria is picking up in 2016. With GDP growth not having exceeded the threshold of 1 percent since 2012, the pace was markedly slower than in Germany. The combination of weak foreign and domestic demand weighed heavily on output growth. While subdued external demand continues to constrain activity, current growth is being driven by a revival of investment and strengthening consumption.

Despite continued population growth, private consumption stagnated in recent years. Main reasons were a squeeze in disposable income and uncertainty caused by mounting unemployment. Also inflation being rather high by international standards dampened private purchasing power.

Table 3: Private consumption, income and prices

	2012	2013	2014	2015	2016	2017
	Percentage changes from previous year, volume					
Private consumption expenditure	+ 0.5	– 0.1	– 0.3	– 0.0	+ 1.5	+ 1.2
Durables	+ 0.8	– 3.0	+ 0.1	– 0.6	+ 2.5	+ 2.0
Non-durables and services	+ 0.5	+ 0.2	– 0.3	+ 0.1	+ 1.4	+ 1.1
Household disposable income	+ 1.9	– 2.1	+ 0.5	– 1.0	+ 2.1	+ 1.3
	As a percentage of disposable income					
Household saving ratio						
Including adjustment for the change in net equity of households in pension fund reserves	9.2	7.3	7.8	6.9	7.5	7.6
Excluding adjustment for the change in net equity of households in pension fund reserves	8.5	6.6	7.0	6.1	6.6	6.7
	Percentage changes from previous year					
Direct lending to domestic non-banks[1]	+ 0.0	– 1.2	+ 0.3	+ 2.0	+ 1.5	+ 2.5
	In percent					
Inflation rate						
National	2.4	2.0	1.7	0.9	1.0	1.7
Harmonised	2.6	2.1	1.5	0.8	1.0	1.7
Core inflation[2]	2.3	2.3	1.9	1.7	1.4	1.6

Source: WIFO. 2016 to 2017: forecast. – [1] End of period. – [2] Excluding unprocessed food (meat, fish, fruits, vegetables) and energy items.

Table 4: Earnings and international competitiveness

	2012	2013	2014	2015	2016	2017
	Percentage changes from previous year					
Wages and salaries per employee[1]						
Gross earnings	+ 2.7	+ 1.9	+ 1.7	+ 1.7	+ 1.4	+ 1.6
Gross real earnings[2]	+ 0.3	– 0.1	– 0.0	+ 0.8	+ 0.4	– 0.1
Net real earnings[2]	– 0.0	– 0.6	– 0.6	+ 0.2	+ 2.9	– 0.2
Unit labour costs						
Total economy	+ 3.0	+ 2.3	+ 2.1	+ 1.5	+ 1.0	+ 1.2
Manufacturing	+ 2.7	+ 2.3	+ 0.9	+ 1.2	+ 0.1	+ 0.1
Effective exchange rate, manufactures						
Nominal	– 1.7	+ 1.8	+ 1.2	– 2.7	+ 1.1	+ 0.1
Real	– 1.6	+ 2.2	+ 1.5	– 2.7	+ 1.2	– 0.3

Source: WIFO. 2016 to 2017: forecast. – [1] Employees according to National Accounts definition. – [2] Deflated by CPI.

Table 5: Technical notes to the projection of real GDP growth

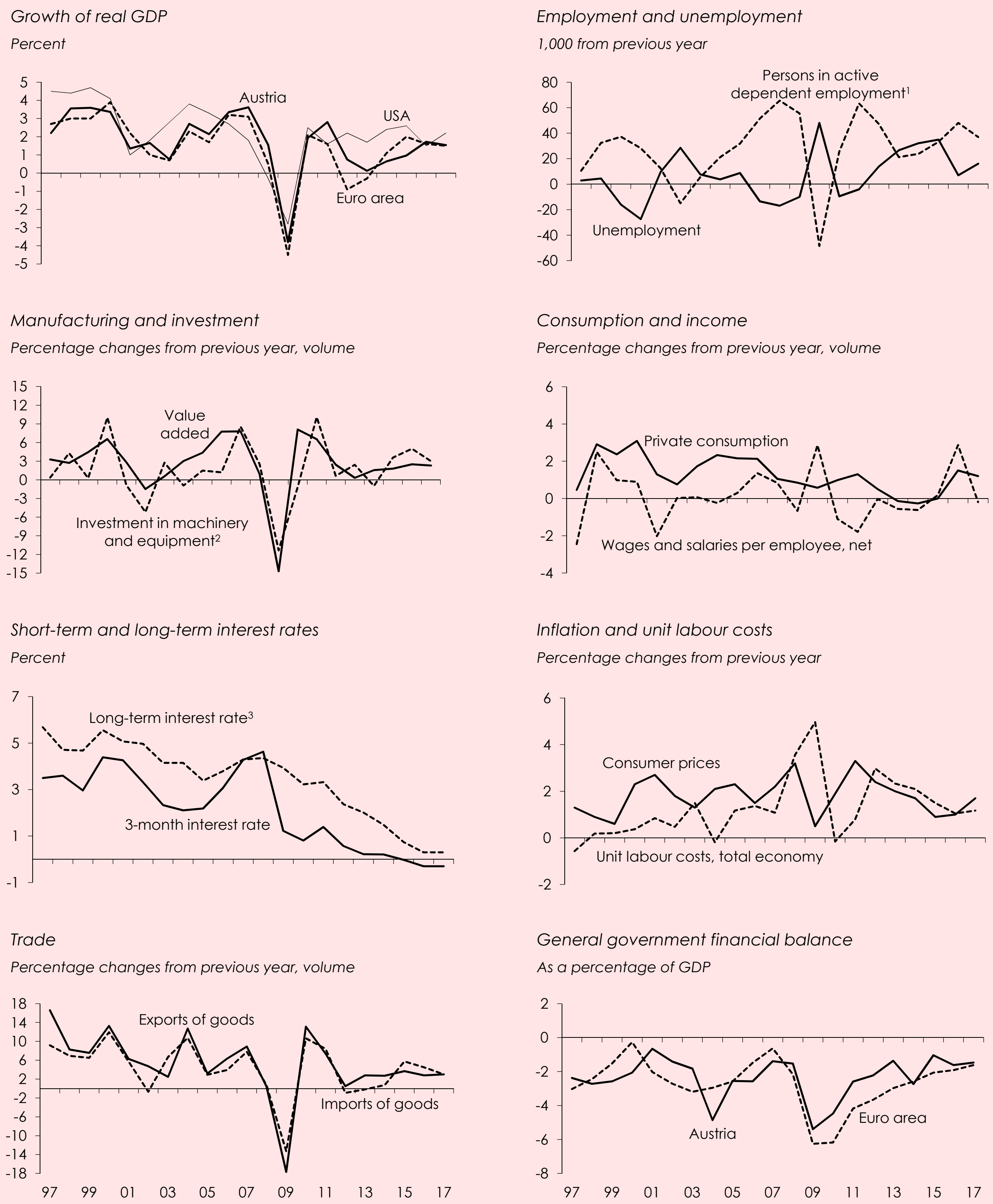
		2014	2015	2016	2017
Carry-over[1]	percentage points	+ 0.3	+ 0.1	+ 0.5	+ 0.6
Growth rate during the year[2]	in percent	+ 0.5	+ 1.2	+ 1.5	+ 1.7
Annual growth rate	*in percent*	*+ 0.6*	*+ 1.0*	*+ 1.7*	*+ 1.5*
Adjusted annual growth rate[3]	in percent	+ 0.7	+ 0.9	+ 1.4	+ 1.7
Calendar effect[4]	percentage points	– 0.1	+ 0.1	+ 0.2	– 0.1

Source: WIFO. 2016 to 2017: forecast. – [1] Impact of year-earlier growth dynamics on growth in the current year. Equals the annual growth rate in the current year, if the level of GDP in the current year remains at the level of the fourth quarter of the previous year; trend-cycle component. – [2] Shows the growth dynamics during a calendar year. Equals the year-on-year growth rate for the fourth quarter; trend-cycle component. – [3] Trend-cycle component. – [4] Impact of working days and the leap day.

While some of these elements continue to play a role, a number of benign special factors take effect this year. First, the tax reform that was introduced on 1 January

2016 lowers the tax burden on labour earnings. For the first time since 2009, net real wages and salaries per capita will grow by a substantial 2.9 percent, after having declined in 2013 and 2014 and gained only 0.2 percent in 2015. As a consequence, purchases of durable consumer goods like motor cars and home furnishings are heading up this year.

Figure 1: Indicators of economic performance



Source: WIFO. 2016 to 2017: forecast. – [1] Excluding persons with valid employment contract receiving child care benefit or being in military service. – [2] 10-year central government bonds (benchmark).

Second, population growth driven by refugee immigration raises consumption growth, mainly concerning non-durable consumer goods. Also the statistical effect of the leap day (corresponding to an increase in the annual number of calendar days of 0.27 percent) plays a positive role. Having edged down by 0.1 percent and 0.3 percent respectively in 2013 and 2014, real private consumption will gain 1.5 percent in 2016 and 1.2 percent in 2017 as the positive one-off factors wear off.

Public consumption expanded by 2.1 percent in 2015, mainly driven by expenditure on refugee care in the second half of the year. Abstracting from this special factor, the underlying trend is rather for a deceleration, which continued in the first half of 2016. In the second quarter, the increase narrowed to an inflation-adjusted 0.2 percent from the previous period (first quarter +0.3 percent). For the entire year, WIFO projects an increase by 1.6 percent, subsiding to +0.9 percent in 2017.

Gross fixed investment gradually gathered pace during 2015, advancing at a solid 1 percent each in the first and second quarter 2016 (in volume, quarter-on-quarter). Purchases of machinery and equipment already exceeded the year-earlier level by nearly 5 percent in the first semester. The bulk of it may be replacement of obsolete equipment, since firms' hesitation for years to invest may have created pent-up demand and their expectations expressed in recent business surveys remain sceptical.

The construction sector will be able to increase output for the first time in several years.

Also investment in construction which has been shrinking during the last three years will return to growth in 2016, estimated at 1.6 percent in volume. While the trend remains negative in civil engineering, residential and non-residential building post strong gains. With the federal government's "residential building campaign" still being in a preparatory stage, tangible positive effects should become visible only late this year and in 2017. Thanks to the rebound in demand, employment of construction workers has increased in the first six months of 2016, for the first time in three years, while the number of registered jobseekers in this sector diminished.

4.1 Weak foreign trade continues to weigh on industrial production

The contribution of net trade to GDP growth is negative this year, as the weak external environment dampens export growth. While total Austrian exports may still increase by 2.8 percent in volume, imports will expand by 3.8 percent due to the reviving demand for durable consumer goods and business equipment. According to the foreign trade statistics, commodity export values rose by only 1.2 percent year-on-year during the first six months of 2016. Deliveries to EU partner countries (+1.9 percent) proved to be a stabilising factor, whereas goods exports to third countries fell by 0.4 percent.

In 2017, exports of goods and services are set to expand by an equally moderate 2.8 percent in real terms, but import growth should ease to +3.0 percent. In this case, the external sector would no longer put a strain on GDP growth.

Table 6: Productivity

	2012	2013	2014	2015	2016	2017
	Percentage changes from previous year					
Total economy						
Real GDP	+ 0.7	+ 0.1	+ 0.6	+ 1.0	+ 1.7	+ 1.5
Hours worked[1]	− 0.3	− 0.6	+ 0.3	− 0.6	+ 0.7	+ 0.7
Productivity per hour	+ 1.1	+ 0.7	+ 0.3	+ 1.6	+ 1.0	+ 0.9
Employment[2]	+ 1.1	+ 0.5	+ 1.0	+ 0.7	+ 1.3	+ 1.1
Manufacturing						
Production[3]	+ 2.4	+ 0.3	+ 1.6	+ 1.8	+ 2.5	+ 2.3
Hours worked[1]	+ 1.1	− 1.1	− 0.0	+ 0.3	+ 0.9	+ 0.3
Productivity per hour	+ 1.3	+ 1.4	+ 1.6	+ 1.5	+ 1.6	+ 2.0
Employees[1]	+ 1.5	− 0.6	+ 0.3	+ 0.7	+ 0.7	+ 0.3

Source: WIFO. 2016 to 2017: forecast. – [1] According to National Accounts definition. – [2] Dependent and self-employed according to National Accounts definition. – [3] Value added, volume.

The unfavourable international environment dampens the advance of industrial output on its underlying upward trend. The production index fell 0.4 percent year-on-year in July, when adjusted for calendar effects. Against the previous month, the index lost 0.5 percent; for the first half year as a whole, output was 2.3 percent higher than one year before.

In the regular WIFO Business Cycle Survey, manufacturing firms (industry and small-scale crafts) confirmed their rising satisfaction with current business conditions and also expressed greater confidence in the short-term outlook. However, Bank Austria's Purchasing Managers' Index edged down in August. Altogether, the prospects are more likely for continued moderate GDP growth rather than for a significant acceleration.

Against this background, manufacturing net output (value added) in 2016 should with +2.5 percent post its strongest volume gain in five years, but receive no additional momentum in 2017.

4.2 Corporate credit demand remains subdued

In spite of further easing interest rates and banks' relaxation of loan standards, firms' demand for credit remains flat.

Corporate financing conditions have further improved. According to Austrian National Bank (OeNB), interest rates on new corporate loans up to 1 million € (weighted across different maturities) have declined towards 2 percent in the last years. The rate on inter-bank loans fell to –0.3 percent in August.

Despite the extremely favourable financing conditions, credit demand by companies has barely increased. According to OeNB, the volume of credit to Austrian non-financial corporations amounted to 133.3 billion € in the second quarter 2016, virtually unchanged from end-2015. The WIFO Business Cycle Survey on current credit conditions suggests the reason being lacklustre credit demand rather than restrictive credit standards applied by banks. Although firms predominantly judge current credit standards as being tough, they rate them much less restrictive than five years ago.

Still more favourable are current financing conditions for the public sector. In early September, the federal government was able to issue new 7-year maturity bonds at a rate of –0.32 percent. The low-interest environment therefore continues to ease massively the public debt service burden.

In real terms, many investments meanwhile carry negative interest rates. In August, the rate of inflation stood unchanged at 0.6 percent. This reduces the real value of future debt redemption as well as interest cost, which makes debt financing extremely attractive.

4.3 Rising commodity prices drive up inflation in 2017

The consumer price index is projected to rise by 1 percent on annual average 2016, barely more than the +0.9 percent recorded for 2015.

The year-on-year increase in the consumer price index remained constant at 0.6 percent in August. In the next few months, the dampening effect of energy prices is set to diminish compared with the first half of the year.

According to Statistics Austria, price hikes in the category "hotel and restaurant services" were a major driver of headline inflation, accounting for 0.28 percentage points of the index increase. These hikes also explain a substantial part of the inflation differential vis-à-vis the euro area.

In August, the EU-wide Harmonised Consumer Price Index (HICP) rose by 0.6 percent year-on-year in Austria, compared with +0.2 percent on average for the euro area. The positive inflation differential vis-à-vis the euro area will also hold for the entire year 2016 but should taper off in 2017.

The present forecast expects energy prices to soon return to an upward trend. The reference price for crude oil (Brent) is assumed to move from an annual average of 45 $ per barrel in 2016 to 57 $ in 2017. Against this background, headline inflation is projected to accelerate to 1.7 percent.

4.4 Job creation gathering pace – rise in unemployment slowing down

Despite weak cyclical conditions, employment kept growing steadily in the last few years. In 2015, the number of persons in active dependent employment went up by 33,200. In 2016 and 2017, livelier economic activity goes hand in hand with a pick-up in employment growth (2016 +48,000 or +1.4 percent; 2017 +37,000 or +1.1 percent). Unlike in recent times, also more full-time jobs are created.

At the same time, labour supply growth will stay buoyant, notably from abroad, even though somewhat less than in 2014 (+64,000) and 2015 (+76,000). WIFO expects an increase by 60,000 persons in 2016 and 58,000 in 2017.

Table 7: Labour market

		2012	2013	2014	2015	2016	2017
		Changes from previous year, in 1,000					
Demand for labour							
Persons in active employment[1]		+ 50.1	+ 29.2	+ 31.8	+ 41.0	+ 53.0	+ 42.0
Employees[2]		+ 47.2	+ 21.2	+ 23.8	+ 33.2	+ 48.0	+ 37.0
Percentage changes from previous year		+ 1.4	+ 0.6	+ 0.7	+ 1.0	+ 1.4	+ 1.1
Nationals		+ 9.0	– 8.5	– 8.1	+ 6.3	+ 13.0	+ 6.0
Foreign workers		+ 38.1	+ 29.7	+ 32.0	+ 27.0	+ 35.0	+ 31.0
Self-employed[3]		+ 2.9	+ 8.0	+ 8.0	+ 7.8	+ 5.0	+ 5.0
Labour supply							
Population of working age	15 to 64 years	+ 18.0	+ 23.5	+ 33.1	+ 52.3	+ 37.8	+ 34.3
	15 to 59 years	+ 22.3	+ 27.2	+ 33.7	+ 44.6	+ 22.6	+ 15.3
Labour force[4]		+ 64.0	+ 55.8	+ 64.0	+ 76.0	+ 60.0	+ 58.0
Surplus of labour							
Registered unemployed[5]		+ 13.9	+ 26.6	+ 32.2	+ 35.0	+ 7.0	+ 16.0
In 1,000		260.6	287.2	319.4	354.3	361.3	377.3
Unemployed persons in training[5]	in 1,000	66.6	73.5	75.3	65.1	68.1	74.1
		In percent					
Unemployment rate							
Eurostat definition[6]		4.9	5.4	5.6	5.7	6.0	6.1
As a percentage of total labour force[5]		6.2	6.8	7.4	8.1	8.2	8.4
National definition[5 7]		7.0	7.6	8.4	9.1	9.2	9.4
Employment rate							
Persons in active employment[1 8]		67.2	67.4	67.6	67.7	68.2	68.5
Total employment[6 8]		71.4	71.4	71.1	71.1	71.4	71.6

Source: WIFO. 2016 to 2017: forecast. – [1] Excluding persons with valid employment contract receiving child care benefit or being in 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).

Despite strengthening labour demand and slower growth of labour supply, no progress will be made in reducing unemployment over the forecast period. The number of jobless persons registered with the labour market service will edge up by 7,000 in 2016 and 16,000 in 2017, implying a marked deceleration from the increase by over 30,000 in 2014 and 2015, respectively.

As a consequence, the rise in unemployment should substantially lose momentum. The projected jobless rate (on national definition) for 2016 of 9.2 percent of the dependent labour force will virtually level off from 2015 (9.1 percent), but resume climbing to 9.4 percent in 2017. The unemployment rate according to Eurostat will move from 5.7 percent this year to 6.0 percent in 2016 and 6.1 percent in 2017.

4.5 General government deficit virtually unchanged

After having significantly narrowed to 1 percent of GDP in 2015, the general government deficit is set to widen again in 2016. The main reasons are the income tax reform (although it is partly counter-financed by tax hikes elsewhere, expenditure restraint and measures against tax fraud), and additional public expenditure of around 2¼ billion € caused by refugee immigration. Assuming persistently restrictive budget execution, the general government balance (Maastricht definition) is projected at –1.6 percent of GDP.

The data currently available on budgetary developments up to July 2016 show buoyant revenues from corporate tax, social contributions and real estate transfer tax. Apart from the shortfalls in wage tax revenues related to the tax reform, the receipts from capital gains tax were markedly lower than expected.

Under economic conditions meeting the present forecast, the general government deficit for 2017 should be expected at 1.5 percent of GDP, virtually unchanged from

2016. The government gross debt ratio will gradually decline from 85.5 percent of GDP in 2015 to 83.7 percent in 2016 and slightly over 82 percent of GDP in 2017.

Downside risks to the projections of deficits and debt will further derive from yet uncertain fiscal liabilities in support of banks in distress.

Table 8: Key policy indicators

	2012	2013	2014	2015	2016	2017
	As a percentage of GDP					
Fiscal policy						
General government financial balance						
According to Maastricht definition	− 2.2	− 1.4	− 2.7	− 1.0	− 1.6	− 1.5
General government primary balance	0.5	1.2	− 0.3	1.3	0.5	0.4
	In percent					
Monetary policy						
3-month interest rate	0.6	0.2	0.2	− 0.0	− 0.3	− 0.3
Long-term interest rate[2]	2.4	2.0	1.5	0.7	0.3	0.3
	Percentage changes from previous year					
Effective exchange rate						
Nominal	− 1.5	+ 1.7	+ 1.2	− 2.8	+ 1.1	+ 0.1
Real	− 1.5	+ 2.1	+ 1.5	− 2.7	+ 1.2	− 0.3

Source: WIFO. 2016 to 2017: forecast. – [1] 10-year central government bonds (benchmark).

5. The risk environment

As usual, the WIFO projection refers to the most likely scenario, given the underlying assumptions, available data and forward-looking indicators. The point-estimates are accompanied by a qualitative assessment of potential alternative developments and risks.

Due to the numerous actual data available until September, forecast risks for average GDP growth in 2016 are minor. Leading indicators such as business surveys draw a highly reliable picture for the rest of the year, with a rather small margin of error even in case of unforeseen events.

For 2017, an element of uncertainty derives from the time lag for the stimulating effects of the tax reform on private consumption to fade away. In the past, the impact of such tax cuts on household spending typically took some time to materialise and also subsided rather gradually. However, since the Austrian economy now finds itself in an entirely different environment of growth and monetary conditions, such experience may not be readily applicable to the latest tax reform.

Another uncertain factor relates to the unconventional monetary policy conducted by the ECB. Interest rates and yields on securities are historically low and even negative in part. Indeed, in September a number of large euro area companies were able to issue bonds carrying negative returns. For an assessment of the associated economic effects any empirical evidence and experience is lacking, and also opinions in the academic community on the theoretical transmission channels are controversial.

The UK vote on leaving the EU is a further potential factor of uncertainty, albeit a minor one. Any effects should emanate from an exchange rate shift, uncertainty on financial markets and slower GDP growth in the UK. The exchange rate of sterling vis-à-vis the euro and the dollar had fallen markedly more strongly in the crisis of 2008-09 than after the referendum, without leaving visible traces in the UK current account. Apparently, the composition of British export and import goods and services exhibits a rather low price elasticity. As witnessed by the relevant indicators, the uncertainty on financial and capital markets has dissipated fairly quickly, making adverse effects on foreign trade flows rather unlikely. The more likely setback to British GDP growth should have an only limited impact on Austria.

The highest risk is the future performance of the US economy and of the emerging markets. While the latest rebound of activity in China is not certain to last, time and strength of a cyclical recovery in Russia as well as in Brazil are unclear. In the immediate aftermath of the recession, the US economy managed to return to a distinctly stronger growth path than the EU. During the last nine months, however, GDP growth has been weaker than that in the crisis-ridden EU. The improvement on the labour market appears to have come to a halt, while business surveys foreshadow sluggish activity up to the end of the year. A positive element, on the other hand, is the resilience of consumer confidence. Finally, a major imponderable is the outcome if the US presidential elections in November 2016.