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## Economic Growth Dampened by Oil Price Hike, but Exceeding the Euro Area Average

### Economic Outlook for 2005 and 2006

**GDP growth will reach only 1.7 percent this year and is expected to move but to a marginally higher rate in 2006. The high energy prices are eating into real disposable income of private households and thereby into consumer demand. Latest survey results show an improvement in industrial confidence which may lead to a recovery in machinery and equipment investment from its low level. Higher public spending on infrastructure, research and the upgrading of qualifications of the labour force has led to a positive growth differential vis-à-vis the euro area, while at the same time widening the budget deficit somewhat further.**

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The Austrian economy has moved to a path of moderate growth. Real GDP rose by 0.4 percent seasonally adjusted in the second quarter from the previous period and may keep a similar pace throughout the second half of the year. Activity is held back mainly by the high costs of energy whose direct share in total consumer expenditure amounts to 7 percent. Their contribution to the increase in consumer prices is close to +½ percentage point. Assuming that the increase in energy prices will be passed on to other goods and services to such a moderate degree as so far, the rate of inflation will average 2.4 percent this year and 2.1 percent in 2006. Real disposable income of private households is growing by only around 1½ percent per year, allowing a gain in private consumption by 1.4 percent in real terms. Such an increase would be higher than last year, but undershoot the long-term average significantly for the fifth year in a row, undermining activity in the trade sector and in other services branches.

The export-oriented industrial sectors are growing faster than those parts of the economy depending mainly on domestic demand. Austrian exporting companies are proving highly competitive, boosting deliveries by a further 4.2 percent this year from the particularly successful performance in 2004, when export volumes jumped by 12.9 percent. Demand is growing notably from the oil-exporting countries whose foreign revenues have risen substantially. Incoming orders from the euro area are faring less well, given the lack of stimulus from internal demand. In the regular WIFO business survey, manufacturing firms have expressed continued uncertainty about the further trend in output, despite the latest improvement in business confidence. If such early signs for an industrial upturn are confirmed, the manufacturing sector may expect an increase in net value added by an inflation-adjusted 2.7 percent this year.

An increase in output and an improvement in medium-term expectations are prerequisites for a revival in machinery and equipment investment. With a projected decline of 1 percent in volume on annual average 2005, corporate investment spending has been subdued so far, despite an altogether comfortable profit situation. Since a large part of investment goods is supplied from abroad, notably machinery and vehicles, sluggish investment, in conjunction with weak consumer pur-

chases of motor cars, is holding back merchandise import growth, projected at 1.7 percent in volume for 2005. For this reason, the trade balance is expected to be in small surplus, notwithstanding the high energy costs.

Table 1: Main results

		2001	2002	2003	2004	2005	2006
		Percentage changes from previous year					
GDP							
Volume		+ 0.8	+ 1.0	+ 1.4	+ 2.4	+ 1.7	+ 1.8
Value		+ 2.6	+ 2.2	+ 2.8	+ 4.4	+ 3.5	+ 3.7
Manufacturing <sup>1</sup> , volume		+ 2.3	+ 0.4	- 0.1	+ 4.6	+ 2.7	+ 3.0
Wholesale and retail trade, volume		+ 2.0	+ 2.0	+ 0.3	+ 1.9	+ 1.2	+ 1.5
Private consumption expenditure, volume		+ 1.0	+ 0.3	+ 1.6	+ 0.8	+ 1.4	+ 1.7
Gross fixed investment, volume		- 1.5	- 5.0	+ 6.1	+ 0.6	+ 0.4	+ 2.4
Machinery and equipment <sup>2</sup>		+ 1.9	- 8.2	+ 7.7	+ 0.8	- 1.0	+ 3.0
Construction		- 4.2	- 2.3	+ 4.8	+ 0.5	+ 1.5	+ 2.0
Exports of goods <sup>3</sup>							
Volume		+ 6.3	+ 4.3	+ 2.6	+12.9	+ 4.2	+ 5.2
Value		+ 6.5	+ 4.2	+ 1.9	+13.9	+ 5.6	+ 6.0
Imports of goods <sup>3</sup>							
Volume		+ 5.5	+ 0.3	+ 6.5	+11.4	+ 1.7	+ 4.1
Value		+ 5.0	- 2.0	+ 5.0	+12.5	+ 4.6	+ 5.7
Current balance	billion €	- 4.13	+ 0.75	- 1.17	+ 0.75	+ 1.24	+ 1.07
As a percentage of GDP		- 1.9	+ 0.3	- 0.5	+ 0.3	+ 0.5	+ 0.4
Long-term interest rate <sup>4</sup>	in percent	5.1	5.0	4.2	4.2	3.4	3.6
Consumer prices		+ 2.7	+ 1.8	+ 1.3	+ 2.1	+ 2.4	+ 2.1
Unemployment rate							
Eurostat definition <sup>5</sup>	in percent	3.6	4.2	4.3	4.8	5.1	5.1
National definition <sup>6</sup>	in percent	6.1	6.9	7.0	7.1	7.2	7.2
Economically active employees <sup>7</sup>		+ 0.4	- 0.5	+ 0.2	+ 0.7	+ 0.9	+ 0.9
General government financial balance according to Maastricht definition							
As a percentage of GDP		+ 0.1	- 0.4	- 1.2	- 1.0	- 1.9	- 2.0

Source: WIFO Economic Outlook. – <sup>1</sup> Value added, including mining and quarrying. – <sup>2</sup> Including other products. – <sup>3</sup> According to Statistics Austria. – <sup>4</sup> 10-year central government bonds (benchmark). – <sup>5</sup> According to Eurostat Labour Force Survey. – <sup>6</sup> According to Labour Market Service, as a percentage of total labour force excluding self employed. – <sup>7</sup> Excluding parental leave, military service, and unemployed persons in training.

Since 1 May 2005, the federal government has adopted a set of measures designed to stimulate economic activity and rein back the marked rise in unemployment. Extra-budgetary funds for the improvement of transport infrastructure and expenditure for research were increased and budget allocations for active labour market policy reinforced. Public investment, in particular, should provide cyclical stimulus, mirrored by substantially higher order levels as reported by civil engineering companies. Since demand for residential construction is also strengthening, overall value added of the construction sector should expand by an inflation-adjusted 1.5 percent in 2005 and 2 percent in 2006.

In 2006, funds for the upgrading of workers' qualifications and for facilitating labour market insertion have been stepped up by one-third. The focus is to be set on subsidies to women returning to the labour market and to young workers and jobseekers, i.e., those problem groups whose situation has deteriorated most during the last few years. WIFO expects that due to these measures a further increase in the unemployment rate in 2006 can be prevented. By then, the number of people out of work will have risen to more than 250,000, corresponding to an unemployment rate of 7.2 percent of the dependent labour force, or 5.1 percent of the total labour force on Eurostat definitions. The overall pattern on the labour market will remain unchanged, with employment heading up by around 1 percent in spite of economic

growth remaining moderate, but labour supply increasing much faster than in the past.

The expansionary budgetary measures adopted since May 2005 should for the larger part become effective next year, with an estimated growth impulse of 0.3 percent of GDP. Owing to this impulse, the Austrian economy should grow slightly faster than the euro area average. At the same time, the additional government spending will lead to a somewhat higher budget deficit. The latter is projected at 2 percent of GDP for 2006, thereby exceeding the benchmark figure laid down in the federal budget and in the Stability Programme.

Prices for internationally traded crude oil have recorded a further massive increase since last summer. At over \$ 60 per barrel in September they exceeded the level of June by one-fifth and have almost tripled since the end of 2001. A turnaround of the price hike is not in sight: first, demand for crude oil and other energy sources remains strong, notably as the strong expansion of the Chinese economy is highly energy-intensive; second, the persistent high global political instability is reflected by a speculative mark-up on prices, which is unlikely to disappear soon. The WIFO forecast therefore assumes an average oil import price for the industrialised countries of \$ 58 per barrel for 2005 and \$ 62 for 2006.

The high energy prices are undermining activity in the advanced economies, because they imply an adverse shift in their terms of trade. Nevertheless, the impact on the European business cycle is smaller than in the 1970s and early 1980s, since the energy intensity of production is nowadays only half the level at that time.

The rise in energy prices, apart from its direct impact on inflation, will spill over to prices of other goods and services via higher energy costs, such as in transport. Because of the squeeze in private households' real disposable income, the share of saving in disposable income will temporarily fall. Low income earners, who save little, will immediately cut their consumption spending, people in other income brackets with a certain delay.

While in the medium term the advanced economies will also see positive effects, when oil exporters spend their additional revenues on consumer durables and capital goods, the growth-depressing impact will nevertheless dominate.

In the long run, the more expensive energy will give rise to substitution effects, such as via changing consumption patterns, energy saving or the implementation of new technologies.

Past experience suggests that an increase in crude oil prices by 10 percent will shave 0.1 percentage point off GDP growth in the euro area as well as in Austria. The oil price hike is expected to cut the growth rate by around ½ percentage point this year and by a similar amount in 2006.

The world economy is still in a period of strong growth, even if its momentum is gradually decelerating. Global output growth is set to moderate from 5 percent in 2004 to around 4 percent in 2006, that of world trade from 8 percent to 7 percent.

Particularly dynamic is the Chinese economy, with output gaining 9 percent or more each year and exports and imports rising by more than twice these rates, illustrating China's rapid integration into the global economy. At the same time, the Chinese expansion is fuelling business activity in Asia at large. Notably Japan is benefiting from lively demand for investment and durable consumer goods. The Japanese economy has come out of stagnation since early 2005, with GDP expected to gain 2¼ percent in volume this year. Still, consumer price deflation has so far not been overcome.

### Oil price hike weakening economic activity

*The rise in oil prices is weighing mainly on consumer demand. GDP growth in the euro area will thereby be reduced by around ½ percentage point both this year and next.*

### Global activity staying robust

*The booming Chinese economy is largely responsible for the swift expansion of world trade. In the USA, growth is expected to stay above an annual rate of 3 percent.*

Table 2: World economy

	2001	2002	2003	2004	2005	2006	
	Percentage changes from previous year						
<i>Real GDP</i>							
Total OECD	+ 1.1	+ 1.3	+ 1.9	+ 3.2	+ 2.4	+ 2.4	
USA	+ 0.8	+ 1.6	+ 2.7	+ 4.2	+ 3.3	+ 3.3	
Japan	+ 0.2	- 0.3	+ 1.4	+ 2.7	+ 2.2	+ 2.3	
EU 25	+ 1.8	+ 1.1	+ 1.1	+ 2.4	+ 1.5	+ 1.6	
EU 15	+ 1.7	+ 1.0	+ 1.0	+ 2.3	+ 1.4	+ 1.5	
Euro area	+ 1.7	+ 0.9	+ 0.7	+ 2.1	+ 1.3	+ 1.4	
Germany	+ 1.2	+ 0.1	- 0.2	+ 1.6	+ 1.0	+ 1.1	
New member states <sup>1</sup>	+ 2.4	+ 2.4	+ 3.7	+ 5.0	+ 4.5	+ 4.5	
China	+ 7.5	+ 8.3	+ 9.3	+ 9.5	+ 9.3	+ 9.0	
<i>World trade, volume</i>	+ 0.1	+ 3.4	+ 4.8	+ 7.9	+ 6.7	+ 7.0	
<i>Market growth<sup>2</sup></i>	+ 2.3	+ 1.8	+ 5.1	+ 8.4	+ 4.5	+ 4.8	
<i>Primary commodity prices</i>							
HWVA index, total	- 8	- 5	- 4	+18	+41	+12	
Excluding energy	- 3	- 6	- 6	+18	+12	+11	
<i>Crude oil prices</i>							
Average import price (cif) for OECD countries	\$ per barrel	23.6	24.1	28.4	36.3	58.0	62.0
<i>Exchange rate</i>							
\$ per euro		0.896	0.945	1.131	1.243	1.25	1.21

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

Also in the USA, lively business activity is driven by buoyant domestic demand. The strength of investment indicates that firms' capacity utilisation and business confidence are high. In 2006, reconstruction works in the areas devastated by the hurricane of last September should provide additional stimulus to construction investment. Consumer demand is set to go up by more than 3 percent. The rise in energy cost is the major factor behind a rate of inflation clearly exceeding 3 percent, which is likely to weigh on private consumption growth. The imbalances in government finances and the current account will remain high. Overheating in key segments of the real estate market constitutes the major cyclical risk in the USA. Barring such risk, the US economy is projected to grow by over 3 percent both in 2005 and 2006.

GDP in the euro area, according to preliminary estimates, rose by little more than 1 percent in volume in the first half of 2005 compared with the year-earlier period. Like in the last five years, activity is held back mainly by weak internal demand. The euro is lacking demand stimulus from the policy side, while rising energy prices are undermining consumer confidence further. For this reason, WIFO does not expect a revival of domestic activity in the countries of the euro area.

However, the euro area is benefiting from the strong expansion of the world economy. Exports and industrial output showed considerable momentum in the first half of the year. The exchange rate of the euro vis-à-vis the dollar has dropped by 11 percent since the beginning of the year, thereby boosting the price competitiveness of European manufactures. Yet, an increase in oil prices has in the past often been accompanied by a depreciation of the dollar. A further appreciation of the euro would provide a considerable risk for industrial activity in the EU. Surveys conducted by the European Commission among industrial firms suggest a slight pick-up in confidence over the summer months. Overall capacity utilisation remains too low, however, for investment to rebound.

Whereas foreign demand and industrial activity suggest a tentative cyclical recovery, consumption by private households is dampened by the high energy prices. WIFO therefore expects that the cyclical sluggishness in the euro area will persist in 2005 and 2006, with growth of real GDP staying at a modest 1¼ to 1½ percent.

Within the euro area, the cyclical pattern is rather uneven. The current situation is particularly weak in Italy, where GDP in the first half of the year was not higher than

### Consumption in the euro area to remain sluggish

*Demand restraint on the part of consumers is holding back business activity in the euro area. Economic policy is focussing on improving supply conditions at the expense of providing additional stimulus to overall demand.*

one year ago. The economy is suffering from a decline in price competitiveness and little capacity to act on the part of economic policy. In Finland, business activity slowed markedly in the first semester, with real GDP up by only ½ percent year-on-year. The momentum was hardly higher in Portugal, the Netherlands and Germany, while France, Belgium and Austria enjoyed somewhat stronger growth of 1½ to 2 percent, respectively. GDP rose notably faster in Ireland, Luxembourg, Spain and Greece.

The substantial discrepancies between growth rates show that even after several years of monetary union business cycles have not become synchronised. Specific influences at the national level continue to play an important role. Apart from the catching-up process in the less developed economies, such influences derive notably from differential trends in real estate prices and their impact on consumption and construction investment, as well as differences in the stance of fiscal policy.

While the cyclical performance of the three EU 15 member states outside monetary union has been relatively better in the last years, growth has most recently abated to around 2 percent. In the UK, this has been due to a decline in real estate prices and a slowdown in industrial activity.

With a projected average rate of 4½ percent this year and next, the new EU member states have managed to increase their growth advantage vis-à-vis the EU 15. After their accession to the EU they have enjoyed high attractiveness for foreign direct investors, but also domestic demand is keeping strong momentum.

After an encouraging performance in the spring and summer of 2004, economic activity in Austria has abated towards a slower pace. Real GDP in the second quarter 2005 rose by 0.4 percent seasonally adjusted from the previous period and 2.1 percent year-on-year. For the third and fourth period, WIFO expects further 0.4 percent quarter-on-quarter gains, yielding an annual increase between 1¼ and 1½ percent for the second semester.

With inflation-adjusted growth rates of 1.7 percent in 2005 and 1.8 percent in 2006, Austria would slightly exceed the euro area average, mainly on account of a somewhat more expansionary fiscal stance. After the cuts in direct taxes as from 2005, spending increases for investment in infrastructure and the promotion of research will take effect in 2006. Together with higher funds for the upgrading of qualifications of jobseekers, these measures are expected to boost GDP growth by around 0.3 percentage point.

Higher public investment will counter the dampening cyclical effects of the energy price hike. The jump in oil prices is squeezing real disposable income, thereby narrowing the scope for higher consumer spending of private households. Private consumption, the largest component accounting for 56 percent of aggregate demand, will in 2005 again rise far below its long-term trend, although more strongly than last year. The slow pace is weighing on output growth in the trade sector and other service branches. A further increase in energy prices would constitute a major risk for the cyclical profile. Therefore, the outlook for 2006 is surrounded by a particularly wide margin of uncertainty.

Exports and industrial output performed better in the first half of 2005 than domestic demand and the sectors mainly depending from the latter. The regular WIFO business survey showed a weakening of business confidence between January and July, but a recovery according to the latest results. Underlying the projections is therefore a tentative strengthening of industrial activity in the second half of the year.

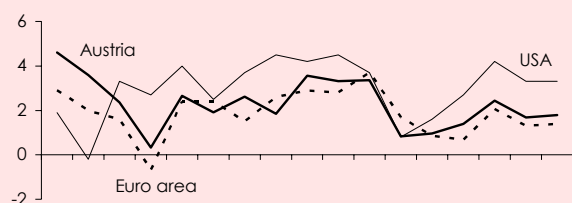
### Moderate pace of growth in Austria

*Economic growth remains moderate in Austria. Although the increase in public spending on infrastructure, research and the upgrading of jobseekers' qualifications provide stimulus to business activity, private consumption is suffering under the impact of high energy costs.*

Figure 1: Indicators of economic performance

## Growth of real GDP

Percent



## Employment and unemployment

1,000 from previous year



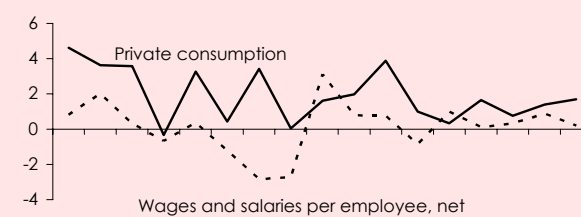
## Manufacturing and investment

Percentage changes from previous year, volume



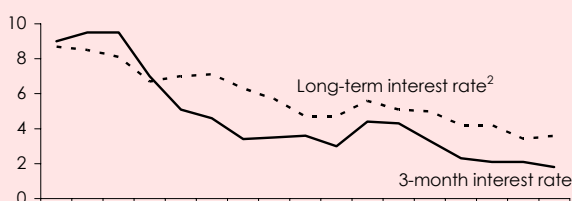
## Consumption and income

Percentage changes from previous year, volume



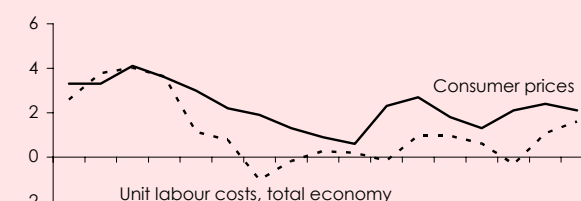
## Short-term and long-term interest rates

Percent



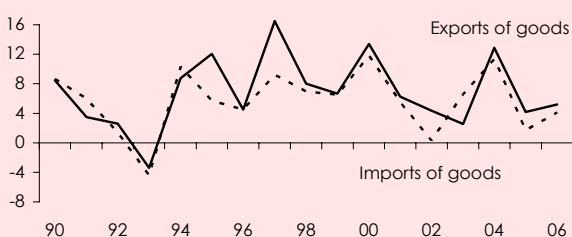
## Inflation and unit labour costs

Percentage changes from previous year



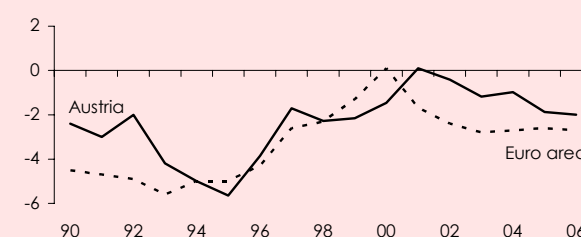
## Trade

Percentage changes from previous year, volume



## General government financial balance

As a percentage of GDP



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

In the first half of this year, growth of merchandise exports fell markedly behind the high rates recorded last year. In nominal terms, exports were 5 percent higher than one year ago. Demand rose particularly strongly from the oil exporting countries and from south-eastern Europe, where Austrian exporters have gained market shares already over the last couple of years. However, overall export growth is constrained by sluggish demand in the euro area, where Italy, Austria's second most important trading partner, is in a recession. The momentum of demand from the new EU mem-

**High price  
competitiveness of the  
export-oriented  
industry**

ber states has slackened markedly, and for a few countries, like Hungary, the foreign trade statistics even show a decline.

In spite of the slow growth of export markets, Austria benefits from the high price competitiveness of exporting firms. Although the euro has appreciated substantially during the last years, unit labour costs have fallen relative to those of the trading partners. The main reason is the strong gain in hourly productivity in manufacturing industry, projected at over 4 percent p.a. until the forecast horizon.

The WIFO projection is for an increase in export volumes by slightly above 4 percent from the very high level attained last year (2004 +12.9 percent). In 2006, export growth may re-accelerate somewhat.

The jump in oil prices is weighing heavily on the trade balance this year. Nevertheless, the latter may improve slightly from last year, with imports of investment goods decreasing and those of passenger cars stagnating. The increase in merchandise import volumes of 1.7 percent is very modest this year, but import prices are going up by a strong 2.9 percent on account of the soaring oil prices. The terms-of-trade will deteriorate significantly.

The current account will move to a small surplus this year, on the back of sluggish goods imports as well as of the spending restraint of Austrians travelling abroad. The official statistics show a slump by 11 percent of real foreign currency disbursements in 2004, a figure difficult to interpret and pointing to problems in the collection of the underlying data. Assuming no change in foreign tourism imports, the tourism services balance is expected to yield a surplus of € 3.4 billion this year. Tourism exports may increase by 1 percent in volume from last year, as earnings of the sector are edging up in spite of overnight stays remaining flat.

Manufacturing value added rose only slightly in the fourth quarter of last year and in early 2005. Provisional data from the national accounts signal a stronger momentum for the second quarter, with a seasonally-adjusted increase by 0.8 percent in volume from the earlier period.

The companies sampled in the regular WIFO business survey showed little optimism until last summer, judging their order situation and production weaker each time. In September, however, the general sentiment improved markedly. If this trend continues, a pick-up in the industrial cycle may be expected for the autumn. In this case, manufacturing value added may increase by 2.7 percent in volume on annual average 2005 and by 3 percent in 2006.

*After the unusually strong gains in 2004, exports keep a strong momentum this year.*

### Current account in surplus despite high energy prices

*Due to the only modest increase in goods imports and the stagnation in spending of Austrian tourists abroad, the current account has moved to a small surplus.*

### Industrial output recovering, labour costs declining

*Turning the negative trend of the last few months, the WIFO business survey of last September indicates an improvement in the manufacturing business climate.*

Table 3: Productivity

	2001	2002	2003	2004	2005	2006
	Percentage changes from previous year					
<i>Total economy</i>						
Real GDP	+ 0.8	+ 1.0	+ 1.4	+ 2.4	+ 1.7	+ 1.8
Employment <sup>1</sup>	+ 0.6	- 0.1	+ 0.1	- 0.0	+ 0.4	+ 0.7
Full-time equivalent	+ 0.5	- 0.2	+ 0.2	+ 0.2	+ 0.4	+ 0.6
Productivity (GDP per employment)	+ 0.2	+ 1.1	+ 1.3	+ 2.5	+ 1.2	+ 1.1
Full-time equivalent	+ 0.3	+ 1.2	+ 1.2	+ 2.2	+ 1.3	+ 1.2
<i>Manufacturing</i>						
Production <sup>2</sup>	+ 2.0	+ 0.4	- 0.0	+ 4.7	+ 2.7	+ 3.0
Employees <sup>3</sup>	+ 0.2	- 2.5	- 1.7	- 0.6	- 0.7	- 0.6
Productivity per hour	+ 2.2	+ 3.5	+ 1.3	+ 4.4	+ 4.3	+ 4.2
Working hours per day per employee <sup>4</sup>	- 0.4	- 0.5	+ 0.3	+ 0.8	- 0.8	- 0.6

Source: WIFO Economic Outlook. – <sup>1</sup> Dependent and self-employed according to National Accounts definition. – <sup>2</sup> Value added, volume. – <sup>3</sup> According to Federation of Austrian Social Security Institutions. – <sup>4</sup> According to "Konjunkturerhebung" of Statistics Austria.

The sustained strong advance in hourly productivity is accompanied by a further decline in industrial employment and another fall in labour costs. Unit labour costs, after a drop by 3.5 percent last year, will go down by another 1 percent in 2005. The unit labour cost position will also improve when compared with the trading partners:

notwithstanding the appreciation of the euro, it will be better by 2 percent in 2005 than five years ago.

Corporate spending on machinery, vehicles and electronic equipment has been disappointing in the first half of the year, being no higher than in the year-earlier period. Apart from the expiry of fiscal incentives, this is explained by the uncertainty surrounding the short-term business outlook. The regular WIFO investment survey, which mainly identifies the cyclical determinants of investment behaviour, gives no hint for a rebound. In spite of a satisfactory profit situation, firms will spend on new equipment only when sales prospects and output pick up significantly, whereas in a period of weak business conditions they will use the high profits for debt repayment. For the current year, WIFO expects a slight decline by 1 percent in real terms of investment in machinery and equipment. Prospects for an improvement in 2006 are still vague.

The regular WIFO survey shows a clear improvement of the business climate for the construction sector. From a weak start early this year, demand and output rebounded strongly. Firms saw their order levels markedly above the long-term average. This is mainly due to developments in civil engineering, which is benefiting from higher government spending on infrastructure projects. The recovery is more moderate in the building sector. While there are signs of revival in residential construction and renovation, the sector of industrial building is suffering from lacklustre investment behaviour, with new projects being frequently postponed. WIFO expects construction output to gain 1.5 percent in volume in 2005, accelerating to 2 percent next year.

Over the last months, inflation as measured by the year-to-year increase in the consumer price index has decelerated. While at the beginning of the year, the inflation rate had been close to 3 percent, it was down to 2.0 percent by August. A major part of the decline is explained by the base effect of strong housing rent increases wearing off, which had pushed up the index between the months of July 2004 and June 2005. However, energy costs at the consumer level remain upward bound. Outlays for domestic energy and fuel were markedly above their year-earlier level in August. For the end of the year, further mark-ups for electricity and gas have been announced. The direct share of the energy component in total consumer expenditure is close to 7 percent. The energy price hike accounts for more than ½ percentage point of headline inflation both this year and next.

In the past, energy price increases had second-round effects, like higher transport costs feeding through to the prices of other goods and services. These indirect effects were of similar magnitude as the direct effects. So far this year, the pass-through of the jump in oil prices has been very limited. Thus, the prices of manufactures for the period from January to August were only ¼ percent higher than one year ago.

With a view to the Austrian tradition of wage formation, whereby the social partners take the macro-economic framework conditions into account, little upward pressure on wages may be expected. This assumption is confirmed by the settlement for the metal workers, providing for an increase in contractual wages by 3.1 percent. In 2005 and 2006, unit labour costs in manufacturing industry are projected to decrease by almost 1 percent each. For the overall economy, nominal unit labour costs may rise by 1.1 percent and 1.6 percent, respectively. Real wage costs, however, will decline further, implying also another reduction of the wage share in national income.

### Prudence on the part of investors

*Investment in machinery and equipment has been disappointing in the first half of the year. Capacity utilisation is too low as to trigger a new investment cycle.*

### Construction benefiting from public orders

*While civil engineering and residential construction enjoy a favourable performance, demand for industrial and commercial building remains sluggish.*

### High energy prices, but limited secondary effects

*Headline inflation will rise to an average rate of 2.4 percent this year. In 2006, it will abate only gradually, remaining at 2.1 percent.*



Table 4: Earnings and international competitiveness

	2001	2002	2003	2004	2005	2006
	Percentage changes from previous year					
Gross earnings per employee <sup>1</sup>	+ 1.4	+ 2.2	+ 1.9	+ 2.0	+ 2.4	+ 2.7
Full-time equivalent	+ 1.6	+ 2.3	+ 1.9	+ 2.1	+ 2.7	+ 2.9
Gross real earnings per employee <sup>1</sup>	- 0.4	+ 1.2	+ 0.4	+ 0.0	± 0.0	+ 0.6
Net real earnings per employee <sup>1</sup>	- 0.8	+ 1.0	+ 0.1	+ 0.3	+ 0.9	+ 0.2
<b>Total economy</b>						
Unit labour costs	+ 1.0	+ 1.0	+ 0.6	- 0.3	+ 1.1	+ 1.6
<b>Manufacturing</b>						
Unit labour costs	+ 0.2	- 0.3	- 0.1	- 3.5	- 0.9	- 0.8
Relative unit labour costs <sup>2</sup>						
Vis-à-vis trading partners	- 2.4	- 0.1	+ 2.5	- 0.9	- 0.8	- 1.0
Vis-à-vis Germany	- 2.5	- 0.4	+ 0.9	+ 0.2	- 1.3	- 1.5
<b>Effective exchange rate, manufactures</b>						
Nominal	+ 0.9	+ 1.3	+ 3.7	+ 1.2	- 0.5	- 0.3
Real	+ 0.5	+ 0.8	+ 2.9	+ 1.0	- 0.3	± 0.0

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

For 2006, WIFO expects headline inflation at 2.1 percent, down from 2.4 percent in 2005. The increase in energy prices is a key element in the upward drift of consumer prices. Core inflation, excluding energy and seasonal items, is projected at only 1½ percent for 2006.

According to the annual national accounts established by Statistics Austria, private consumption edged up by only 0.8 percent in volume in 2004, significantly less than derived by WIFO in its preliminary calculations of last March. The lower figure is "explained" by an implausible fall of expenditure by Austrian tourists abroad by 11 percent in real terms, which points to methodological problems in the data collection. A higher level of consumer spending than officially recorded is also suggested by the unusually strong increase in the saving ratio from 7.8 percent to 8.4 percent of disposable income.

Up by an inflation-adjusted 0.9 percent year-on-year, the momentum of consumer spending hardly accelerated in the first half of 2005, as real disposable income was squeezed by higher inflation. Once inflationary pressure starts to abate, real incomes should post slightly higher gains in the second half of the year, yielding an annual average increase of 1¼ percent. Assuming a modest increase in the saving ratio, real private consumption may expand by 1.4 percent this year, roughly 1 percentage point less than corresponding to the long-term average. No significant acceleration may be expected for 2006.

Value added of the trade sector also disappointed in the first half of the year, rising by only 0.8 percent in volume from the year-earlier level. Sales of motor cars were lower than last year. Wholesale trade benefited from lively exports, but was held back by the decline in investment. Assuming a gradual recovery in the second semester, WIFO projects for the whole year 2005 an increase in real value added of the trade sector by 1.2 percent.

Value added of other private service branches continues to outpace the performance of the trade sector. For the banking and insurance sector, WIFO expects an increase in net output by 3 percent, the third year of strong performance in a row.

## Consumer demand remaining feeble

*The relatively high inflation is dampening the rise in disposable income and consumer spending of private households.*

Table 5: Private consumption, income and prices

	2001	2002	2003	2004	2005	2006
	Percentage changes from previous year, volume					
Private consumption expenditure	+ 1.0	+ 0.3	+ 1.6	+ 0.8	+ 1.4	+ 1.7
Durables	+ 0.2	+ 0.3	+ 3.2	+ 0.6	+ 2.1	+ 1.9
Non-durables and services	+ 1.1	+ 0.3	+ 1.5	+ 0.8	+ 1.3	+ 1.7
Household disposable income	+ 0.1	+ 0.4	+ 1.5	+ 1.6	+ 1.7	+ 1.6
	As a percentage of disposable income					
Household saving ratio	7.6	7.6	7.8	8.4	8.7	8.7
	Percentage changes from previous year					
Direct lending to domestic non-banks <sup>1</sup>	+ 3.5	+ 1.2	+ 1.6	+ 5.0	+ 2.9	+ 2.7
	Percentage changes from previous year					
Inflation rate						
National	2.7	1.8	1.3	2.1	2.4	2.1
Harmonised	2.3	1.7	1.3	2.0	2.3	2.0
Core inflation <sup>2</sup>	2.3	2.0	1.3	1.6	1.7	1.5

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

In spite of the cyclical weakness, the number of people in dependent active employment is expected to rise by some 28,000 or 0.9 percent each in 2005 and 2006. Female employment is set to rise more than male, since the bulk of the increase may concern part-time jobs. The employment ratio (i.e., people in active employment as a percentage of the population of working age) will move up to 63.2 percent in 2006.

### Qualification measures keeping unemployment in check

In 2006, the rise in unemployment should level off, on the back of the substantial increase in spending on active labour market policy measures.

Table 6: Labour market

		2001	2002	2003	2004	2005	2006
		Changes from previous year, in 1,000					
<i>Demand for labour</i>							
Economically active employment <sup>1</sup>		+13.9	-11.6	+ 8.5	+25.1	+33.0	+34.5
Employees <sup>2</sup>		+12.4	-15.0	+ 5.5	+21.1	+28.0	+29.0
Percentage changes from previous year		+ 0.4	- 0.5	+ 0.2	+ 0.7	+ 0.9	+ 0.9
Nationals		+ 3.0	-20.1	-10.4	+ 9.2	+16.0	+12.0
Foreign workers		+ 9.5	+ 5.1	+15.9	+11.9	+12.0	+17.0
Self-employed <sup>3</sup>		+ 1.5	+ 3.4	+ 3.0	+ 4.0	+ 5.0	+ 5.5
<i>Labour supply</i>							
Population of working age	15 to 64 years	+36.3	+42.9	+ 37.7	+34.4	+12.7	+9.0
	15 to 59 years	- 5.2	+13.4	+21.2	+35.6	+45.7	+40.5
Labour force <sup>4</sup>		+23.5	+17.0	+16.1	+28.9	+40.5	+36.5
<i>Surplus of labour</i>							
Registered unemployed <sup>5</sup>		+ 9.6	+28.5	+ 7.7	+ 3.8	+ 7.5	+ 2.0
In 1,000		203.9	232.4	240.1	243.9	251.4	253.4
		Percent					
<i>Unemployment rate</i>							
Eurostat definition <sup>6</sup>		3.6	4.2	4.3	4.8	5.1	5.1
As a percentage of total labour force <sup>5</sup>		5.5	6.2	6.3	6.4	6.5	6.5
National definition <sup>5,7</sup>		6.1	6.9	7.0	7.1	7.2	7.2
<i>Employment rate</i>							
Economically active employment <sup>1,8</sup>		63.2	62.5	62.2	62.3	62.7	63.2
Total employment <sup>6,8,9</sup>		-	-	-	67.5	68.0	68.4

Source: WIFO Economic Outlook. – <sup>1</sup> Excluding parental leave, military service, and unemployed persons in training. – <sup>2</sup> According to Federation of Austrian Social Security Institutions. – <sup>3</sup> According to WIFO. – <sup>4</sup> Economically active employment plus unemployment. – <sup>5</sup> According to Labour Market Service. – <sup>6</sup> According to Eurostat Labour Force Survey. – <sup>7</sup> As a percentage of total labour force, without self-employed. – <sup>8</sup> As a percentage of population of working age (15 to 64 years). – <sup>9</sup> Changed survey method.

Developments on the labour market are importantly influenced by the strong expansion of labour supply. The working age population will continue to rise strongly in the years to come<sup>1</sup>.

The number of unemployed is rising further by a significant amount this year. The projected annual average total of 251,000 will exceed the year-earlier level by 7,000 persons. In 2006, a comprehensive programme for the upgrading of jobseekers' qualifications will take effect. It will focus on the employability of key problem groups on the labour market, such as for young people and women seeking to return to the labour market. If these measures can be implemented successfully, unemployment should rise no further in 2006. WIFO expects the rate of unemployment at 7.2 percent of the dependent labour force (according to the conventional national definition) or 5.1 percent of the total labour force in conformity with the EU Labour Force Survey.

Tax revenues for the period from January to July exceeded the budgeted amounts. Apart from higher indirect tax receipts (possibly as a result of more efficient measures to combat tax evasion and fraud), intake from profit taxes surprised on the positive side, reflecting the good earnings situation of domestic companies. The general government deficit in the Maastricht definition should therefore remain contained below the mark of 2 percent of GDP.

In 2006, the deficit is likely to turn out higher than in the current year. Subdued economic growth will bear down on tax and social contribution revenues, and corporate tax receipts will fall on account of the tax reform of 2005. Moreover, government expenditure is likely to exceed the budgetary plans, given the recently announced measures to upgrade labour force qualifications and the increase in retirement benefits. As a result, the budget deficit will be higher than foreseen in the federal budget draft and in the Stability Programme.

## Government deficit at 2 percent of GDP

*The general government balance is set to weaken slightly next year. Apart from the recent tax cuts, this is due to the recently decided allocation of additional funds to investment and qualification of the workforce.*

Table 7: Key policy indicators

	2001	2002	2003	2004	2005	2006
	As a percentage of GDP					
<i>Fiscal policy</i>						
General government financial balance						
According to Maastricht definition	+0.1	-0.4	-1.2	-1.0	-1.9	-2.0
According to National Accounts	-0.0	-0.6	-1.3	-1.1	-2.0	-2.1
General government primary balance	+3.5	+2.7	+1.7	+1.9	+0.9	+0.7
	Percent					
<i>Monetary policy</i>						
3-month interest rate	4.3	3.3	2.3	2.1	2.1	1.8
Long-term interest rate <sup>1</sup>	5.1	5.0	4.2	4.2	3.4	3.6
	Percentage changes from previous year					
<i>Effective exchange rate</i>						
Nominal	+1.0	+1.4	+3.8	+1.2	-0.6	-0.3
Real	+0.3	+0.6	+2.8	+0.9	-0.4	-0.1

Source: WIFO Economic Outlook. – <sup>1</sup> 10-year central government bonds (benchmark).

<sup>1</sup> The population projections are essentially based upon registrations. However, these data are considered not entirely reliable, for which reason it would be advisable to carry out a population census.