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International Downturn Weighing on Domestic Activity

Economic Outlook for 2008 and 2009

Following an increase by 3.1 percent in 2007, economic growth in Austria will moderate to 2 percent this year. While demand and output in the first half of 2008 were clearly more dynamic than in the euro area as a whole, the momentum has slowed steadily since the beginning of the year. Confidence among domestic companies is receding. The cyclical downturn in the USA, high oil prices and exchange rate moves holding back export growth will continue to burden the economy in 2009. Real GDP is expected to advance by a modest 0.9 percent, overshadowing developments also on the labour market where employment growth will level off and the fall in unemployment turn around. The projections rest on the assumption that the adverse effects of the financial market crisis on the real economy will be contained.

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Global economic activity is losing steam this year and next, with the downturn covering all major economies. In the USA, expansionary policy measures will support economic growth in 2008 and 2009, by which time business activity should gradually recover. The crisis on real estate and financial markets will nevertheless continue to weigh on US growth for the next years.

Following the lively momentum at the beginning of the year, demand and output in the euro area have slackened considerably. This is a consequence not so much of the financial crisis in the USA but rather of the cyclical downturn in the world's leading economy, the high dollar-euro exchange rate and the drain in purchasing power caused by the jump in commodity prices. Unlike in the USA, policy in the euro area is largely refraining from taking counter-cyclical action. GDP growth is expected to trail that in the USA in both years. Also in the euro area, a cyclical turnaround is unlikely to set in before mid-2009.

The international economic downturn is taking its toll also on activity in Austria. While, unlike in the euro area as a whole, GDP increased further in the second quarter 2008, the regular business survey points to an imminent loss of momentum. Notably exports should suffer further from the slackening demand abroad as well as from the unfavourable exchange rate to the dollar. Volume exports in 2008 will rise by only half the rate recorded last year and diminish further in 2009.

With the slower pace of activity, investment is likely to level off. After an increase by 4.7 percent in 2007, gross fixed capital formation is projected to advance by only 2.2 percent this year and to remain flat in 2009. Whereas construction investment is keeping up the lively pace of last year, spending on machinery and business equipment is edging up by less than half the rate of 2007. In 2009, the slowdown will extend to both components of corporate spending, with equipment investment even shrinking in real terms.

Private consumption is set to remain subdued over the years to come. While the deceleration of inflation and the expansionary stance of fiscal policy will boost household disposable income, developments on the labour market will have a dampen-

ing influence. Private household consumption is projected to expand by just above 1 percent in volume each in 2008 and 2009.

Table 1: Main results

		2004	2005	2006	2007	2008	2009
		Percentage changes from previous year					
GDP							
Volume		+ 2.5	+ 2.9	+ 3.4	+ 3.1	+ 2.0	+ 0.9
Value		+ 4.2	+ 5.0	+ 5.3	+ 5.3	+ 4.9	+ 3.2
Manufacturing ¹ , volume		+ 3.0	+ 4.8	+ 9.6	+ 5.5	+ 3.2	+ 0.5
Wholesale and retail trade, volume		- 0.0	+ 2.2	- 1.0	+ 1.5	+ 1.2	+ 1.1
Private consumption expenditure, volume		+ 2.2	+ 2.6	+ 2.4	+ 1.0	+ 1.0	+ 1.2
Gross fixed investment, volume		+ 0.7	+ 2.4	+ 2.6	+ 4.7	+ 2.2	+ 0.0
Machinery and equipment ²		- 0.4	+ 5.5	+ 0.9	+ 6.8	+ 2.5	- 0.5
Construction		+ 1.6	- 0.4	+ 4.2	+ 2.8	+ 2.0	+ 0.5
Exports of goods ³							
Volume		+ 12.7	+ 3.2	+ 6.8	+ 8.7	+ 4.1	+ 3.1
Value		+ 13.9	+ 5.4	+ 9.5	+ 10.5	+ 5.5	+ 3.3
Imports of goods ³							
Volume		+ 11.2	+ 2.9	+ 4.1	+ 8.0	+ 3.8	+ 2.7
Value		+ 12.5	+ 5.9	+ 8.0	+ 9.6	+ 6.2	+ 2.9
Current balance	billion €	+ 4.84	+ 4.92	+ 6.29	+ 8.76	+ 8.06	+ 7.66
As a percentage of GDP		+ 2.1	+ 2.0	+ 2.4	+ 3.2	+ 2.8	+ 2.6
Long-term interest rate ⁴	in percent	4.2	3.4	3.8	4.3	4.3	4.1
Consumer prices		+ 2.1	+ 2.3	+ 1.5	+ 2.2	+ 3.4	+ 2.2
Unemployment rate							
Eurostat definition ⁵	in percent	4.8	5.2	4.8	4.4	3.9	4.2
National definition ⁶	in percent	7.1	7.3	6.8	6.2	5.8	6.3
Persons in active dependent employment ⁷		+ 0.7	+ 1.0	+ 1.7	+ 2.1	+ 2.4	+ 0.5
General government financial balance according to Maastricht definition							
As a percentage of GDP		- 4.4	- 1.5	- 1.5	- 0.4	- 0.6	- 1.0

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

Domestic headline inflation peaked in June 2008 and has since moved to a gradual downward trend. The easing of commodity and agricultural product prices should allow the decline to continue. The annual rate for 2008 will nevertheless be close to 3.4 percent. In 2009, price pressures should further abate; in addition, the cut in VAT for medicines and the abolition of student fees will have a dampening impact. The rate of inflation is set to moderate to 2.2 percent.

Although economic growth in Austria is gradually losing steam, the labour market has been remarkably resilient so far. In August, employment still went up by 80,000 or 2.4 percent year-on-year and unemployment diminished by 3.8 percent or 7,000 persons. However, compared with the previous month, a turnaround is already visible. In 2009, employment will only increase by 0.5 percent on account of the subdued cyclical conditions, and the rate of unemployment as measured by conventional national definitions will edge up from 5.8 percent to 6.3 percent.

Government tax revenues continued to grow strongly in 2008. Despite the increase in public expenditure, the general government balance shows a ratio of -0.6 percent of GDP. In 2009, the business cycle slowdown will be reflected in the government accounts: including the discretionary increase in expenditure decided so far, the deficit will widen to 1 percent of GDP in 2009 not containing the latest business cycle stimulus package decided on the 22nd October 2008. Although fiscal policy

moves thereby to an expansionary stance that is warranted by cyclical conditions, it does not honour its commitments to budgetary savings as laid down in the latest update of the Stability and Growth Programme.

The simultaneous cyclical downturn in the three major economic zones, i.e., the USA, Europe and Japan, will dampen further growth also in the BRICs (Brazil, Russia, India and China) where the momentum has been very strong so far. Global economic growth in 2008 is estimated at 4 percent, implying a slowdown by 1 percentage point from 2007. The lower turning point will be passed in the course of 2009, when annual average growth should decline to 3.2 percent.

The substantial price increases for raw materials and agricultural products are driving up inflation worldwide this year. Going forward, upward pressure on commodity prices should ease, however. While in the long term, oil prices will continue to rise slowly due to the run-down in natural reserves and the steady increase in fuel consumption, the speculative component of demand is much more important for short- and medium-term price movements. This component has indeed been responsible for the latest price jump. For 2009, the reference price of oil is assumed to moderate from an annual average of \$ 105 to \$ 90 per barrel, which should support the cyclical recovery expected to set in during the year.

Global economic activity slackening

Table 2: World economy

	2004	2005	2006	2007	2008	2009
	Percentage changes from previous year					
<i>Real GDP</i>						
World	+ 4.9	+ 4.4	+ 5.0	+ 4.9	+ 4.0	+ 3.2
Total OECD	+ 3.1	+ 2.4	+ 3.0	+ 2.5	+ 1.5	+ 1.0
USA	+ 3.6	+ 2.9	+ 2.8	+ 2.0	+ 1.7	+ 0.9
Japan	+ 2.7	+ 1.9	+ 2.4	+ 2.1	+ 1.1	+ 0.7
EU 27	+ 2.5	+ 1.9	+ 3.1	+ 2.9	+ 1.6	+ 1.0
Euro area 16	+ 2.1	+ 1.7	+ 2.8	+ 2.6	+ 1.2	+ 0.7
New EU countries ¹	+ 5.7	+ 4.8	+ 6.6	+ 6.0	+ 4.4	+ 3.5
China	+10.1	+10.4	+11.1	+11.4	+ 9.5	+ 8.2
<i>World trade, volume</i>	+11.1	+ 8.2	+ 9.5	+ 7.1	+ 4.8	+ 4.0
<i>Market growth²</i>	+ 9.4	+ 7.5	+11.0	+ 7.6	+ 4.8	+ 2.8
<i>Primary commodity prices</i>						
HWVA index, total	+18.5	+28.5	+19.7	+ 3.7	+28	- 3
Excluding energy	+18.1	+ 5.6	+22.0	+ 9.5	+14	- 9
<i>Crude oil prices</i>						
Brent, \$ per barrel	38.2	54.4	65.1	72.5	105.0	90.0
<i>Exchange rate</i>						
\$ per euro	1.243	1.245	1.256	1.371	1.50	1.40

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

The financial market crisis is not expected to trigger liquidity disruptions outside the USA and the UK. Indeed, the forecast assumes that distrust and aversion to lend will remain contained within the banking sector and not spread to relations with the corporate sector and private households. Any liquidity shortages will be offset by the central banks. While financial market turbulences should ease in the further course of 2008 and 2009, the repercussions on the real economy will continue to be felt for several years in the USA, the UK, Ireland and Spain.

The slackening of activity in the USA became apparent already in 2007. In the fourth quarter, GDP growth decelerated from the previous three-months-period. At 0.2 percent, it remained modest in the first quarter 2008, before picking up to 0.7 percent in the subsequent period, exceeding the pace in the euro area. Roughly half of the increase was accounted for by private consumption, as households spent the gains from the tax rebates earlier and to a greater extent than widely expected. While this

US economic policy markedly expansionary

readiness to spend will support GDP growth in 2008, it also points to the financial strain that many households are suffering. Given the slump in asset values, the low saving ratio and the gloomy business outlook, a stronger increase in the propensity to save would have been considered more likely.

Apart from private consumption, the contribution to growth from the external sector has been increasing for some time. The weakness of the dollar has fuelled exports and dampened imports. Investment, however, has moved to a steady downward trend. As a consequence of the real estate crisis, residential investment has been falling for ten quarters in a row. In other categories, gross fixed investment is still expanding, albeit at a steadily decreasing pace since the middle of 2007.

Annual GDP growth in 2008 is expected at 1.7 percent. In 2009, the stimulating forces from policy will ebb: budgetary constraints will limit the scope for fiscal action, while monetary policy will need to pay higher attention to price stabilisation, as US headline inflation rose to 5.6 percent in July 2008, before edging down to 5.4 percent in August. In 2009, average GDP growth is thus projected to slow to a modest 0.9 percent. However, in the course of the year the US cycle should reach its lower turning point and start heading up thereafter.

The impact of discretionary policy measures and the repercussions of the real estate and financial market crisis are difficult to predict, rendering the short-term outlook for the US economy particularly uncertain at the present juncture. It appears plausible, nevertheless, that once the current turmoil has tapered off GDP growth will follow a somewhat slower medium-term trend than observed at the times of the internet bubble and the real estate price boom.

In the first quarter 2008, euro-area GDP rose by 0.7 percent in real terms from the previous period. In the second quarter, the rate dropped to -0.2 percent with a downturn in all demand components. Private consumption edged down by 0.2 percent, investment by 1.2 percent. Both exports and imports fell by 0.4 percent. All major economies in the euro area posted a decline or stagnation of their GDP. In Germany, demand and output receded by 0.5 percent in volume in the second quarter 2008 compared with the previous three-months-period, in France and Italy by 0.3 percent each. The Spanish economy stagnated (+0.1 percent).

Among the euro-area countries, the financial and real estate crisis will hit directly only Spain and Ireland. In other countries a credit squeeze has not been observed so far, and the banking sector appears to be resilient despite important financial losses in some cases. However, the crisis has probably triggered substantial indirect effects on business activity which have spread quickly across the entire euro area. In addition, both countries had to cope with a substantial drain in purchasing power as a result of the jump in oil prices.

As from the middle of 2007 and still more in 2008, industrial confidence faded in the euro area. Manufacturing output grew only slowly and by July 2008 had been falling for the third time in a row. In the first seven months of 2008, non-euro-area exports increased by a nominal 8 percent year-on-year. The strength of the euro is weighing more and more on export growth. Over the same period, merchandise exports to the USA, the second-most important trading partner behind the UK, contracted by 4 percent. However, solid export gains were recorded in trade with China and Russia. The present projections rest on the assumption of some weakening of the exchange rate pressure, with the relation to the dollar coming down from an annual average \$ 1.50 per euro to \$ 1.40 in 2009.

The real estate and financial market crisis is likely to dampen US economic growth in a medium-term perspective. This year and next, GDP growth will nevertheless exceed that of the euro area, due to the pronounced expansionary policy stance. Apart from the tax rebates most of which have already been paid out during the second quarter, the rescue operations for banks and insurance companies initiated by the government and the Central Bank should not only support confidence, but also provide positive incentives for economic activity.

Following the fiscal stimulus to US private demand via tax rebates, comprehensive measures are being taken to rein back the financial market crisis. Despite the strong rise in inflation, monetary policy keeps key interest rates low and stabilises the financial sector by supplying liquidity and buying shares of banks in difficulties.

Prospects for the euro area significantly reduced

After a strong start into the year, economic growth came to a halt in the major euro-area economies. The international downturn, the export-adverse exchange rate and the rise in inflation led to a slump in business confidence in 2008. In addition, unlike in the USA, policy measures to stimulate economic activity are absent. Although the US economy has been hit to a relatively higher degree by the financial and real estate crisis, growth in the euro area will fall below that of the USA both this year and next.

Figure 1: Indicators of economic performance



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

The year-on-year rate of inflation in the euro area rose to a peak of 4 percent in June and July, before easing to 3.8 percent in August, with a decline of 0.1 percentage point over the previous month. The strongest price hikes in August compared with the year-earlier level were again recorded for transport (+6.3 percent) – a consequence of the high fuel prices – and food (+6.2 percent). In both categories, upward pressure should abate in the months to come. For the current projections, the reference price for crude oil has been assumed to average \$ 105 per barrel in 2008 and \$ 90 per barrel in 2009. Wage costs have so far hardly added to upward price pressure; indeed, with an annual increase of 2.7 percent, the labour cost index rose less in the second quarter than in the two previous periods.

The cyclical downswing in the euro area is showing early signs also on the labour market. Employment growth has decelerated steadily over the last few quarters, down to a modest 0.2 percent from the previous period in the second quarter 2008.

Inflation receding in the euro area, labour market facing downturn

The unemployment rate rose to 7.3 percent of the labour force in April 2008 and has since levelled off.

The geographical vicinity to the dynamic markets in East-Central Europe has in the past not only stabilised, but also stimulated economic developments in the euro area. Many companies embarked on large-scale direct investment in the region in order to secure their competitiveness on international markets. In Austria it was mainly the suppliers of financial services who opened new markets for themselves in this area. The process of catching up economically called for substantial financial resources, and also private households increased their indebtedness to an important degree. While the latter remains below that observed in other industrialised countries, the speed of this process carries the risk of the credits extended being insufficiently backed up by assets.

The cyclical overheating accompanying the swift catching-up process in East-Central Europe may come to an abrupt end, which implies an important risk particularly for the Austrian economy. If to a rising extent financial claims cannot be settled, not only domestic exporters would be negatively affected, but also the banking system. The present projections are not based upon such a crisis scenario, but still assume a significant deceleration of growth in the area.

Unlike in many other European countries, the Austrian economy stayed robust in the first half of the year. While growth has also lost momentum since the end of 2007, GDP still edged up by 0.4 percent quarter-on-quarter between April and June. Manufacturing output, a leading indicator, weakened markedly, though. Surveys among domestic companies suggest that the downward trend may accelerate. For the second semester, the forecast is for a stagnation of GDP, with the possibility of a temporary decline. On annual average, GDP growth should nevertheless amount to 2 percent. No substantial improvement should be expected for the first half of 2009; only thereafter will the forces of expansion prevail, leading to a recovery of the business cycle. On annual average, GDP growth is unlikely to exceed the mark of 1 percent.

The slackening of global demand and output is taking its toll on Austria's foreign trade and the appetite for investment. Domestic private consumption remains sluggish, although with a volume growth rate of 1.2 percent lending support to overall activity in the absence of incentives from abroad. Monetary policy should not be expected to switch towards expansion within the projection period: too important is the concern of the ECB that the high inflation will translate into high wage claims, thereby jeopardising price stability in the longer run.

Austria's fiscal policy, on the other hand, will strengthen real household income in the years to come. One factor is the decision on measures to combat inflation, like the cut in VAT on pharmaceuticals and the abolition of student fees; another is the significant increase in public transfers such as retirement and family benefits. While these measures will support business activity, they run counter to the budgetary target laid down in the Stability Programme.

The economies of the OECD area are set to grow by 1.5 percent overall in 2008, 1 percentage point less than last year. A further slowdown to 1 percent growth is projected for 2009. The dollar/euro exchange rate rose to a peak of \$ 1.6 per euro in the course of 2008; the annual average is projected at \$ 1.50 per euro, implying an appreciation of nearly 10 percent vis-à-vis 2007. Both elements will hold back Austrian export growth. Whereas merchandise exports still posted an increase by 8.7 percent in volume in 2007, expectations for the current year are for only half that rate (around 4 percent). In the first six months, the year-on-year increase was 4.5 percent; the quarterly figures show a slowdown already in the first quarter (+1 percent from the previous period, following a rate of 1.2 percent), which became more pro-

Stability in East-Central Europe threatened by real estate and financial market crisis

Austria: signs of an early cyclical downturn

Results from business surveys point to an imminent cyclical downturn also in Austria. While monetary policy has so far not reacted to this prospect, domestic fiscal policy is moving towards a more expansionary stance.

International downturn weighing on Austrian exports

nounced in the period from April to June (+0.4 percent). With the slowdown likely to continue until mid-2009, the annual increase may moderate to 3 percent in 2009.

As the exchange rate exerts a dampening effect on exports this year, Austrian companies will find it difficult to maintain their foreign market shares. With an effective depreciation of the euro projected for 2009 it should be possible to compensate for any such losses.

The adverse external conditions will affect in particular the domestic manufacturing sector. While output growth had passed its peak already in the first half of 2007, it still remained buoyant up to the first quarter 2008 (+1.2 percent quarter-on-quarter). Only in the following three months, it dropped sharply to 0.2 percent.

Austrian merchandise exports will rise by only 4 percent in volume in 2008, due to the cyclical downturn in key foreign markets and the unfavourable exchange rate vis-à-vis the dollar.

Table 3: Productivity

	2004	2005	2006	2007	2008	2009
	Percentage changes from previous year					
<i>Total economy</i>						
Real GDP	+ 2.5	+ 2.9	+ 3.4	+ 3.1	+ 2.0	+ 0.9
Employment ¹	+ 0.4	+ 1.1	+ 1.5	+ 1.7	+ 1.7	+ 0.4
Productivity (GDP per employment)	+ 2.2	+ 1.7	+ 1.9	+ 1.3	+ 0.3	+ 0.6
<i>Manufacturing</i>						
Production ²	+ 2.9	+ 4.8	+ 9.9	+ 5.5	+ 3.2	+ 0.5
Employees ³	- 0.6	- 0.8	+ 0.2	+ 2.6	+ 0.9	- 1.7
Productivity per hour	+ 2.7	+ 6.2	+ 9.5	+ 3.2	+ 2.1	+ 2.6
Working hours per day per employee ⁴	+ 0.8	- 0.6	+ 0.2	- 0.3	+ 0.2	- 0.4

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

Results from the regular WIFO business survey suggest that the downward trend will continue. Although manufacturing succeeded to raise its value added by nearly 5 percent from last year in the 1st semester, the projection for the annual average 2008 is down to a rate of 3.2 percent. For 2009, output growth is expected to edge up by only 0.5 percent, with results for the first six months probably negative and a recovery taking hold gradually in the course of the year.

In the construction industry, a period of strong growth is coming to an end. 2006 and 2007 have seen a substantial increase in construction investment, up to a peak in the second half of 2006. The positive trend continued into the first semester of 2008, employment rose swiftly and firms have until now given positive judgements on their order situation. Apart from lively demand, the price hikes for construction inputs have pushed construction prices upward.

WIFO expects the benign development of construction to prevail in the second half of 2008. However, growth looks set to slacken markedly in 2009. Follow-up projects are lacking in civil engineering, such that overall activity will edge up by a modest 0.5 percent in volume.

Investment in machinery and equipment is typically more sensitive to cyclical variations. After a gain of almost 7 percent in volume in 2007, a further increase in the current year will be limited to 2.5 percent, followed by a projected decline of 0.5 percent in 2009. This profile should not be interpreted as a consequence of past over-investment, but rather as following the usual cyclical pattern.

Austrian tourism service exports in 2008 are likely to gain 3.4 percent in volume from 2007, although hosting the European soccer championship had only neglectible positive effects. In nominal terms, earnings from cross-border travel will rise by 7 percent, more than in 2007. The earlier part of the last summer season (until August) yielded an increase in earnings by 6.6 percent year-on-year. While demand was particularly lively from eastern neighbouring countries, overnight stays of customers from the USA fell far short of last year's level, mainly due to the depreciation of the dollar.

Stagnation of investment

Gross fixed investment is likely to expand by 2.2 percent in 2008, only half the rate recorded for 2007. Given the overall short-term outlook, a further weakening in 2009 is likely. Also construction activity, which still enjoyed solid growth in the current year, can hardly expect a further increase. The loss of momentum will be felt particularly in civil engineering.

Positive results in 2008 tourism, followed by deceleration

The positive trend is likely to end in 2009. The business cycle slowdown will have negative effects on labour markets in all countries of origin, leading to a weaker demand for travel abroad.

The price jump for crude oil and agricultural commodities on world markets drove domestic inflation up to unusually high levels around mid-2008. In June, the year-on-year rate reached a peak of 3.9 percent, before edging down by 0.1 percentage point each in July and August. Oil prices have eased further since, and the forecast assumes the downward trend to continue. Prices for agricultural products may also be expected to come down further. Against this background, a steady decline in the rate of inflation seems likely.

Table 4: Earnings and international competitiveness

	2004	2005	2006	2007	2008	2009
	Percentage changes from previous year					
Gross earnings per employee ¹	+ 1.8	+ 2.4	+ 3.2	+ 2.3	+ 3.0	+ 3.3
Gross real earnings per employee ¹	- 0.2	+ 0.1	+ 1.4	+ 0.1	- 0.4	+ 1.1
Net real earnings per employee ¹	- 0.1	+ 0.7	+ 1.3	- 0.0	- 0.8	+ 0.7
Total economy						
Unit labour costs	- 0.6	+ 0.7	+ 1.1	+ 0.8	+ 3.0	+ 2.7
Manufacturing						
Unit labour costs	- 0.7	- 0.9	- 4.4	- 0.6	+ 1.0	+ 1.3
Relative unit labour costs ²						
Vis-à-vis trading partners	+ 1.0	- 0.1	- 2.9	+ 1.0	+ 1.3	± 0.0
Vis-à-vis Germany	+ 1.3	+ 1.7	- 1.6	+ 2.5	± 0.0	- 1.2
Effective exchange rate, manufactures						
Nominal	+ 1.5	- 0.6	+ 0.2	+ 1.2	+ 1.7	- 0.1
Real	+ 1.1	- 0.9	- 0.4	+ 0.8	+ 1.0	- 1.0

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

In addition, the cut in VAT for pharmaceuticals and the abolition of student fees, both recently adopted by Parliament, will have a dampening effect on the overall price level.

Despite an increase in gross earnings per capita of 3 percent in 2008 and a substantial expansion of employment, real disposable household income is growing only modestly. The tax burden and the strong upturn of inflation have a considerable dampening impact, leaving scope for private consumption to gain 1 percent in volume in the current year.

While the weakening on the labour market will overshadow earnings developments in 2009, real disposable household income will be strengthened by the easing of inflation. An expansionary fiscal policy will also boost incomes via higher transfer payments. Although the saving ratio is expected to edge down, consumption growth is set to disappoint once again. A further dampening factor is the stagnation in tourism imports observed over the last few years.

In spite of the persistent sluggishness of private consumption, its momentum in 2009 will still exceed the rate of GDP growth, thereby playing a kind of stabilising role during the cyclical downswing.

Inflation easing markedly

Having reached a peak at 3.9 percent in June 2008, headline inflation decelerated slightly in the subsequent months. For the year as a whole, inflation is projected at 3.4 percent, subsiding to 2.2 percent in 2009. Apart from raw materials and agricultural products, fiscal policy measures will also contribute to the moderation in 2009.

Private consumption remaining subdued

Spending by private households will grow by little more than one percent also in 2008 and 2009. The easing of inflation, a decline in the saving ratio as well as an expansionary stance of fiscal policy will strengthen the development of private consumption, but the slowdown in employment growth is bound to hold back the increase in disposable income.

Table 5: Private consumption, income and prices

	2004	2005	2006	2007	2008	2009
	Percentage changes from previous year, volume					
Private consumption expenditure	+ 2.2	+ 2.6	+ 2.4	+ 1.0	+ 1.0	+ 1.2
Durables	+ 3.7	+ 5.9	+ 7.0	+ 6.2	+ 0.8	+ 1.7
Non-durables and services	+ 2.1	+ 2.2	+ 1.9	+ 0.4	+ 1.0	+ 1.1
Household disposable income	+ 2.4	+ 3.1	+ 3.5	+ 2.2	+ 1.0	+ 1.1
	As a percentage of disposable income					
Household saving ratio	9.4	9.8	10.8	11.7	11.5	11.4
	Percentage changes from previous year					
Direct lending to domestic non-banks ¹	+ 5.0	+ 4.7	+ 4.5	+ 3.6	+ 4.3	+ 4.2
	Percentage changes from previous year					
Inflation rate						
National	2.1	2.3	1.5	2.2	3.4	2.2
Harmonised	2.0	2.1	1.7	2.2	3.4	2.2
Core inflation ²	1.6	1.5	1.3	1.9	2.5	2.1

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

Despite a gradual deceleration of economic activity, the number of people in dependent active employment rose substantially above the year-earlier level in the first half of 2008. In July and August, the increase amounted to some 80,000 persons or 2.4 percent. However, the year began with two breaks in the statistical series whose impact remains uncertain. First, the reclassification of economic activities blurred the comparison with earlier data. Second, the shortening of the period for registration of newly hired workers with the social security administration implied an increase in the officially recorded employment figures (probably affecting in particular the construction and tourism sectors). Even apart from these effects, demand for labour has apparently been strong this year. A comparison with the previous period reveals, however, that the expansion has clearly lost momentum since last spring. For the current year, the increase in dependent active employment is expected at 2.4 percent; in the course of the cyclical downturn, this rate will diminish to 0.5 percent in 2009.

Likewise, the number of registered unemployed is falling markedly year-on-year, by 7,300 or 3.8 percent last August. The jobless rate of 5 percent of the dependent labour force was 0.3 percentage point lower than in August 2007. In the month-to-month comparison of the seasonally adjusted figures, unemployment went up by 0.5 percent between June and July, but levelled off in August.

For the whole year 2008, the unemployment rate (on national definitions) is projected at 5.8 percent, rising to 6.3 percent in 2009. The harmonised rate (Eurostat) would go up from 3.9 percent to 4.2 percent.

Lively growth of demand and output led to unexpectedly high tax revenues in 2007 and the 1st half of 2008. At the same time, policy adopted a series of budgetary measures that weaken the budget balance in 2008. Among these are an increase in child care and family benefits, subsidies to heating costs for the elderly and the carrying-forward of the latest adjustment of retirement benefits. The general government deficit will thereby amount to 0.6 percent of GDP.

Labour market favourable in 2008, but turnaround imminent

In the first six months of 2008, job creation was still strong and unemployment declined further year-on-year. However, a comparison with the previous period suggests that the cycle has passed the upper turning point. In 2009, employment will hardly increase further and unemployment will head up.

Budget deficit widening significantly in 2009

A reliable forecast for 2009 is undermined by the lack of a Federal budget draft. The business cycle slowdown is likely to be reflected also in the government accounts. Tax revenues are set to be less buoyant, while upward pressure on expenditure will mount, such as for unemployment compensation. Including further the measures recently adopted by Parliament, the general government deficit may rise to 1.0 percent of GDP. The widening of the fiscal gap, caused by automatic stabilisers and discretionary measures, will at the current juncture contribute to cyclical stabilisation; at the same time, however, it will violate the commitment to budgetary consolidation as laid down in the latest update of the Austrian Stability Programme.

The cyclical slackening of activity and the expansionary fiscal measures recently adopted will widen the general government deficit from 0.6 percent of GDP this year to 1.0 percent in 2009. While this stance may be appropriate from the cyclical perspective, it runs counter to the commitment to a balanced budget.

Table 6: Labour market

	2004	2005	2006	2007	2008	2009
	Changes from previous year, in 1,000					
<i>Demand for labour</i>						
Persons in active employment ¹	+ 25.1	+ 37.2	+ 55.9	+ 66.9	+ 86.0	+ 13.0
Employees ²	+ 21.1	+ 31.9	+ 51.5	+ 65.5	+ 78.0	+ 15.0
Percentage changes from previous year	+ 0.7	+ 1.0	+ 1.7	+ 2.1	+ 2.4	+ 0.5
Nationals	+ 9.2	+ 20.0	+ 35.0	+ 43.6	+ 54.0	+ 5.5
Foreign workers	+ 11.9	+ 11.9	+ 16.5	+ 21.9	+ 24.0	+ 9.5
Self-employed ³	+ 4.0	+ 5.3	+ 4.4	+ 1.4	+ 8.0	- 2.0
<i>Labour supply</i>						
Population of working age						
15 to 64 years	+ 34.4	+ 15.6	+ 18.5	+ 17.4	+ 18.0	+ 20.2
15 to 59 years	+ 35.6	+ 48.5	+ 52.8	+ 18.8	+ 8.5	+ 13.7
Labour force ⁴	+ 28.9	+ 45.9	+ 42.4	+ 50.0	+ 72.5	+ 35.0
<i>Surplus of labour</i>						
Registered unemployed ⁵	+ 3.8	+ 8.8	- 13.5	- 16.9	- 13.5	+ 24.0
In 1,000	243.9	252.7	239.2	222.2	208.7	232.7
	Percent					
<i>Unemployment rate</i>						
Eurostat definition ⁶	4.8	5.2	4.8	4.4	3.9	4.2
As a percentage of total labour force ⁵	6.4	6.5	6.1	5.6	5.2	5.7
National definition ^{5,7}	7.1	7.3	6.8	6.2	5.8	6.3
<i>Employment rate</i>						
Persons in active employment ^{1,8}	62.3	62.8	63.6	64.5	65.9	65.9
Total employment ^{6,8,9}	67.8	68.6	70.2	71.4	72.8	72.8

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

Table 7: Key policy indicators

	2004	2005	2006	2007	2008	2009
	As a percentage of GDP					
<i>Fiscal policy</i>						
General government financial balance						
According to Maastricht definition	- 4.4	- 1.5	- 1.5	- 0.4	- 0.6	- 1.0
According to National Accounts	- 4.5	- 1.6	- 1.7	- 0.5	- 0.7	- 1.2
General government primary balance	- 1.5	+ 1.4	+ 1.2	+ 2.3	+ 2.1	+ 1.7
	Percent					
<i>Monetary policy</i>						
3-month interest rate	2.1	2.2	3.1	4.3	4.8	4.7
Long-term interest rate ¹	4.2	3.4	3.8	4.3	4.3	4.1
	Percentage changes from previous year					
<i>Effective exchange rate</i>						
Nominal	+ 1.5	- 0.7	+ 0.2	+ 1.1	+ 1.7	± 0.0
Real	+ 1.0	- 1.0	- 0.5	+ 0.7	+ 0.9	+ 1.0

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