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**Cautious Recovery of Domestic  
Demand**

**Economic Outlook for 2006 and 2007**

**March 2004**

# **Cautious Recovery of Domestic Demand**

**Economic Outlook for 2006 and 2007**

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March 2004

## **Economic Outlook for 2006 and 2007: Cautious Recovery of Domestic Demand**

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*Austria's economy is expected to expand by 2.4 percent in real terms this year, slightly faster than the euro area average. Exports and manufacturing output continue to drive activity forward, and a revival of investment in machinery and equipment is deemed imminent. Higher wage settlements and low inflation will allow private household spending to recover. The labour market is shaped by a strong increase in part-time jobs and rising labour supply. The number of unemployed should decline this year, due to public expenditure on training measures being reinforced.*

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In the export-oriented sector of the Austrian economy, business activity remains favourable, with merchandise exports expected to gain 6.5 percent in volume this year. Notably the domestic suppliers of motor vehicle components should profit from the carrying forward of purchases in Germany to be expected in the run-up to the VAT increase on 1 January 2007. Demand from the oil-exporting countries as well as from the EU accession candidates Bulgaria and Romania is rising briskly. Fuelled by strong exports, domestic manufacturing value added will increase by an inflation-adjusted 5 percent this year, taking the boom in the industrial sector into its third year.

In spite of the favourable climate as regards both demand and financing conditions, domestic corporate investment has remained flat up to the end of 2005. Results from the regular WIFO investment and business climate tests suggest for the motor vehicles and the steel industry as well as for machinery and plant installation that the repeatedly deferred investment projects are now about to be implemented. Overall, investment in machinery and equipment may increase by 4 percent in volume this year.

The construction sector also takes an optimistic view on its order situation. Output and investment should go up by 2.5 percent in 2006, supported notably by higher investment in road construction and a pick-up of industrial building. Demand for new

homes is rising also as a result of swift population growth, calling for a substantial housing supply increase over the medium term.

Most recently, conditions for a tentative recovery of private consumption have also improved. Wage settlements of an average 2¾ percent have been higher than in the last few years. Despite the high energy prices, consumer price inflation eased markedly in early 2006. On annual average, headline inflation may moderate to 1.7 percent, allowing per-capita real incomes to rise by ¾ percent in net terms. Assuming no further increase in the saving ratio, the trend in disposable income would enable private consumption to go up by 1.9 percent in volume. Such an increase would significantly exceed the average for the last five years (+1 percent p.a.), but still fall short of the long-term trend rate of 2¼ percent.

A revival of consumer demand would impact favourably on both the labour market and public finances. Private consumption is substantially more labour-intensive than exports and also more rich in tax and social contribution revenues. The number of people in dependent active employment is projected to rise by 34,000 from last year. Following the trend of the last years, the bulk of the jobs newly created will be part-time, mainly sought by women. However, even the number of full-time jobs may start heading up, after having declined significantly over the last five years. The construction sector is adding to its workforce, and in manufacturing the momentum of output growth is such that despite sizeable productivity gains job losses have virtually come to an end.

Labour supply keeps rising at a solid pace, due to the continued inflow of foreign labour and a decline in new claims for early retirement. Short-term relief for the strained labour market situation is not in sight. Nevertheless, due to higher public spending on active labour market policy, the average number of person enrolled in training activities will be higher by 11,000 than last year. Since these will not be counted as unemployed, the registered jobless figure will edge down by 3,000 from last year. For next year, no further extension of funds earmarked for qualification measures is foreseen, and the subsidies from the European Social Fund are likely to be cut. The official unemployment figure is expected to increase by 5,000 to a level of 255,000 in 2007.

The general government deficit has been widening markedly in recent years and is expected to reach some € 5 billion or 1.9 percent of GDP this year. Healthy corporate profits and the pick-up of wages and consumer spending will be reflected in higher tax and contribution revenues. However, also public expenditure may turn out higher than budgeted, given rising costs for purchases of material goods and personnel and since additional funds have been committed for labour market policy, research and education. No Federal budget bill has yet been submitted for 2007. On the basis of the present growth forecast and assuming restraint being exerted on public expenditure the projection is for a general government deficit in the order of 1½ percent of GDP.

The projection rests on a number of relatively optimistic assumptions:

- oil prices remain high, but without rising further;
- the euro depreciates slightly against the dollar;
- short- and long-term interest rates will but slightly increase further;
- the real estate price bubble in the USA will not burst, such that consumer expenditure will decelerate only gently;
- restraint on private investment in Austria will come to an end;
- the private household propensity to save will not increase further.

The short-term risks to the forecast lie mainly with the assumptions on the international scenario. As regards Austria, it remains to be seen whether the expected revival of investment in machinery and equipment actually materialises. Private consumption may advance even somewhat more strongly if a decline in the propensity to save can be achieved. In 2007, growth may turn out a bit stronger than the 2 percent assumed in the present WIFO projections, if in the EU, supported by an increase of public investment in infrastructure, innovation and education that would be required in order to achieve the Lisbon goals, a powerful cyclical upswing would be set in motion.

Vienna, 29 March 2006.

*For more details, please refer to Markus Marterbauer, Tel. (1) 798 26 01/303, e-mail address [mailto:Markus.Marterbauer@wifo.ac.at?subject=Economic Outlook 2006 and 2007](mailto:Markus.Marterbauer@wifo.ac.at?subject=Economic%20Outlook%202006%20and%202007)*

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Projections - March 2006

## Main results

Percentage changes from previous year

		2002	2003	2004	2005	2006	2007
<b>GDP</b>							
Volume		+ 1,0	+ 1,4	+ 2,4	+ 1,9	+ 2,4	+ 2,0
Value		+ 2,2	+ 2,8	+ 4,4	+ 4,0	+ 4,3	+ 4,0
<b>Manufacturing<sup>1</sup>, volume</b>		+ 0,4	- 0,1	+ 4,6	+ 3,4	+ 5,0	+ 4,2
<b>Wholesale and retail trade, volume</b>		+ 2,0	+ 0,3	+ 1,9	+ 0,4	+ 1,9	+ 1,9
<b>Private consumption expenditure, volume</b>		+ 0,3	+ 1,6	+ 0,8	+ 1,4	+ 1,9	+ 2,0
<b>Gross fixed investment, volume</b>		- 5,0	+ 6,1	+ 0,6	+ 0,9	+ 3,2	+ 2,7
Machinery and equipment <sup>2</sup>		- 8,2	+ 7,7	+ 0,8	+ 0,2	+ 4,0	+ 3,5
Construction		- 2,3	+ 4,8	+ 0,5	+ 1,5	+ 2,5	+ 2,0
<b>Exports of goods<sup>3</sup></b>							
Volume		+ 4,3	+ 2,6	+ 12,9	+ 3,2	+ 6,5	+ 5,7
Value		+ 4,2	+ 1,9	+ 13,9	+ 4,6	+ 7,4	+ 6,2
<b>Imports of goods<sup>3</sup></b>							
Volume		+ 0,3	+ 6,5	+ 11,4	+ 1,9	+ 5,5	+ 5,4
Value		- 2,0	+ 5,0	+ 12,5	+ 4,8	+ 6,8	+ 6,2
<b>Current balance</b>	€ bn	+ 0,75	- 0,48	+ 0,58	+ 1,16	+ 1,63	+ 1,83
	as a percentage of GDP	+ 0,3	- 0,2	+ 0,2	+ 0,5	+ 0,6	+ 0,7
<b>Long-term interest rate<sup>4</sup></b>	percent	5,0	4,2	4,2	3,4	4,0	4,3
<b>Consumer prices</b>		+ 1,8	+ 1,3	+ 2,1	+ 2,3	+ 1,7	+ 1,9
<b>Unemployment rate</b>							
Eurostat definition <sup>5</sup>	percent	4,2	4,3	4,8	5,2	5,2	5,2
National definition <sup>6</sup>	percent	6,9	7,0	7,1	7,2	7,1	7,2
<b>Persons in active dependent employment<sup>7</sup></b>		- 0,5	+ 0,2	+ 0,7	+ 1,0	+ 1,1	+ 0,9
<b>General government financial balance</b>							
according to Maastricht definition							
as a percentage of GDP		- 0,4	- 1,2	- 1,0	- 1,7	- 1,9	- 1,5

<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, percent of total labour force excluding self employed. <sup>7</sup> Excluding parental leave, military service, and unemployed persons in training.

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**Key policy indicators**

	2002	2003	2004	2005	2006	2007
<b>Fiscal policy</b>						
	As a percentage of GDP					
<b>General government financial balance</b>						
according to Maastricht definition	- 0,4	- 1,2	- 1,0	- 1,7	- 1,9	- 1,5
according to National accounts	- 0,6	- 1,3	- 1,1	- 1,8	- 2,0	- 1,6
<b>General government primary balance</b>	+ 2,7	+ 1,7	+ 1,9	+ 1,1	+ 0,9	+ 1,2
<b>Monetary policy</b>						
	Percent					
3-month interest rate	3,3	2,3	2,1	2,2	2,7	3,0
Long-term interest rate <sup>1</sup>	5,0	4,2	4,2	3,4	4,0	4,3
	Percentage changes from previous year					
<b>Effective exchange rate</b>						
Nominal	+ 1,3	+ 3,8	+ 1,2	- 0,6	- 0,6	- 0,3
Real	+ 0,6	+ 2,9	+ 0,9	- 0,7	- 1,2	- 0,9

<sup>1</sup> 10-year central government bonds (benchmark).

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World economy

Percentage changes from previous year

	2002	2003	2004	2005	2006	2007
<b>Real GDP</b>						
World	+ 2,8	+ 3,8	+ 5,1	+ 4,4	+ 4,6	+ 4,4
Total OECD	+ 1,5	+ 2,0	+ 3,3	+ 2,6	+ 2,9	+ 2,8
USA	+ 1,6	+ 2,7	+ 4,2	+ 3,5	+ 3,3	+ 3,0
Japan	+ 0,1	+ 1,8	+ 2,3	+ 2,7	+ 2,3	+ 2,5
EU 25	+ 1,2	+ 1,2	+ 2,4	+ 1,5	+ 2,2	+ 2,0
EU 15	+ 1,1	+ 1,0	+ 2,3	+ 1,4	+ 2,1	+ 1,9
Euro area	+ 0,9	+ 0,7	+ 2,1	+ 1,3	+ 2,1	+ 1,9
Germany	+ 0,1	- 0,2	+ 1,6	+ 0,9	+ 1,9	+ 1,2
New members <sup>1</sup>	+ 2,6	+ 3,8	+ 5,1	+ 4,6	+ 4,0	+ 4,0
China	+ 8,3	+ 9,3	+ 9,5	+ 9,3	+ 9,0	+ 9,0
<b>World trade, volume</b>	+ 3,4	+ 4,9	+ 8,1	+ 7,3	+ 8,5	+ 8,0
<b>Market growth<sup>2</sup></b>	+ 2,0	+ 5,6	+ 9,1	+ 5,5	+ 6,3	+ 5,5
<b>Primary commodity prices</b>						
HWWA Index, total	- 5	- 4	+ 18	+ 29	+ 21	+ 4
Excluding energy	- 6	- 6	+ 18	+ 6	+ 15	+ 8
<b>Crude oil prices</b>						
Average import price (cif) for OECD countries	24,1	28,4	36,3	50,3	59,0	58,0
<b>Exchange rate</b>						
USD per euro	0,945	1,131	1,243	1,245	1,16	1,12

<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.



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## Private consumption, income and prices

	2002	2003	2004	2005	2006	2007
	Percentage changes from previous year, volume					
<b>Private consumption expenditure</b>	+ 0,3	+ 1,6	+ 0,8	+ 1,4	+ 1,9	+ 2,0
Durables	+ 0,3	+ 3,2	+ 0,6	+ 1,7	+ 2,4	+ 2,2
Non-durables and services	+ 0,3	+ 1,5	+ 0,8	+ 1,4	+ 1,8	+ 2,0
<b>Household disposable income</b>	+ 0,7	+ 2,3	+ 1,2	+ 2,1	+ 1,9	+ 1,9
<b>Household saving ratio</b>						
As a percentage of disposable income	7,7	8,6	9,0	9,5	9,6	9,5
	Percentage changes from previous year					
<b>Direct lending to domestic non-banks<sup>1</sup></b>	+ 1,2	+ 1,6	+ 5,0	+ 4,7	+ 5,4	+ 5,0
	Percentage changes from previous year					
<b>Inflation rate</b>						
National	1,8	1,3	2,1	2,3	1,7	1,9
Harmonised	1,7	1,3	2,0	2,1	1,9	1,9
Core inflation <sup>2</sup>	2,0	1,3	1,6	1,5	1,7	1,7

<sup>1</sup> End of period.

<sup>2</sup> Excluding unprocessed food (meat, fish, fruits, vegetables) and energy items.

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## Productivity

Percentage changes from previous year

	2002	2003	2004	2005	2006	2007
<b>Total economy</b>						
Real GDP	+ 1,0	+ 1,4	+ 2,4	+ 1,9	+ 2,4	+ 2,0
Employment <sup>1</sup>	- 0,1	+ 0,1	- 0,0	+ 0,6	+ 0,8	+ 0,8
<b>Productivity</b> (GDP per employment)	+ 1,1	+ 1,3	+ 2,5	+ 1,3	+ 1,6	+ 1,2
<b>Manufacturing</b>						
Production <sup>2</sup>	+ 0,4	- 0,0	+ 4,7	+ 3,5	+ 5,0	+ 4,2
Employees <sup>3</sup>	- 2,5	- 1,7	- 0,6	- 0,9	- 0,2	- 0,5
<b>Productivity per hour</b>	+ 3,5	+ 1,3	+ 4,5	+ 5,0	+ 5,0	+ 4,9
Working hours per day per employee <sup>4</sup>	- 0,5	+ 0,3	+ 0,8	- 0,5	+ 0,2	- 0,2

<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.

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## Earnings and international competitiveness

Percentage changes from previous year

	2002	2003	2004	2005	2006	2007
<b>Gross earnings</b> per employee <sup>1</sup>	+ 2,2	+ 1,9	+ 2,0	+ 2,4	+ 2,8	+ 2,5
<b>Gross real earnings</b> per employee <sup>1</sup>	+ 1,2	+ 0,4	+ 0,0	+ 0,4	+ 1,1	+ 0,6
<b>Net real earnings</b> per employee <sup>1</sup>	+ 1,0	+ 0,1	+ 0,3	+ 1,0	+ 0,8	+ 0,3
<i>Total economy</i>						
<b>Unit labour costs</b>	+ 1,0	+ 0,6	- 0,3	+ 1,1	+ 1,2	+ 1,2
<i>Manufacturing</i>						
<b>Unit labour costs</b>	- 0,3	- 0,1	- 3,5	- 1,5	- 2,1	- 1,9
<b>Relative unit labour costs</b> <sup>2</sup>						
Vis-à-vis trading partners	- 0,6	+ 2,9	- 0,8	- 0,3	- 1,1	- 1,3
Vis-à-vis Germany	- 1,5	+ 1,5	+ 0,3	+ 2,0	+ 0,4	- 0,4
<b>Effective exchange rate - manufactures</b>						
Nominal	+ 1,2	+ 3,7	+ 1,2	- 0,5	- 0,5	- 0,3
Real	+ 0,8	+ 3,0	+ 1,0	- 0,5	- 1,0	- 0,8

<sup>1</sup> Employees according to National Accounts definition.

<sup>2</sup> In a common currency; minus sign indicates improvement of competitiveness.

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Projections - March 2006

## Labour market

Changes from previous year (1,000<sup>s</sup>)

		2002	2003	2004	2005	2006	2007
<b>Demand for labour</b>							
Persons in active employment <sup>1</sup>		- 11,6	+ 8,5	+ 25,1	+ 36,9	+ 39,5	+ 32,5
Employees <sup>2</sup>		- 15,0	+ 5,5	+ 21,1	+ 31,9	+ 34,0	+ 27,0
<i>Percentage changes from previous year</i>		- 0,5	+ 0,2	+ 0,7	+ 1,0	+ 1,1	+ 0,9
Nationals		- 20,1	- 10,4	+ 9,2	+ 20,0	+ 17,0	+ 13,0
Foreign workers		+ 5,1	+ 15,9	+ 11,9	+ 11,9	+ 17,0	+ 14,0
Self-employed <sup>3</sup>		+ 3,4	+ 3,0	+ 4,0	+ 5,0	+ 5,5	+ 5,5
<b>Labour supply</b>							
Population of working age	(15 to 64 years)	+ 42,9	+ 37,7	+ 34,4	+ 12,7	+ 9,0	+ 20,2
	(15 to 59 years)	+ 13,4	+ 21,2	+ 35,6	+ 45,7	+ 40,5	+ 24,9
Labour force <sup>4</sup>		+ 17,0	+ 16,1	+ 28,9	+ 45,6	+ 36,5	+ 37,5
<b>Surplus of labour</b>							
Registered unemployed <sup>5</sup>		+ 28,5	+ 7,7	+ 3,8	+ 8,8	- 3,0	+ 5,0
	1,000 <sup>s</sup>	232,4	240,1	243,9	252,7	249,7	254,7
<b>Unemployment rate</b>							
Eurostat definition <sup>6</sup>	percent	4,2	4,3	4,8	5,2	5,2	5,2
Percent of total labour force <sup>5</sup>	percent	6,2	6,3	6,4	6,5	6,4	6,4
National definition <sup>5,7</sup>	percent	6,9	7,0	7,1	7,2	7,1	7,2
<b>Employment rate</b>							
Persons in active employment <sup>1,8</sup>	percent	62,5	62,2	62,3	62,8	63,4	63,7
Total employment (Eurostat) <sup>6,8,9</sup>	percent	-	-	67,8	68,0	68,2	68,3

<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.

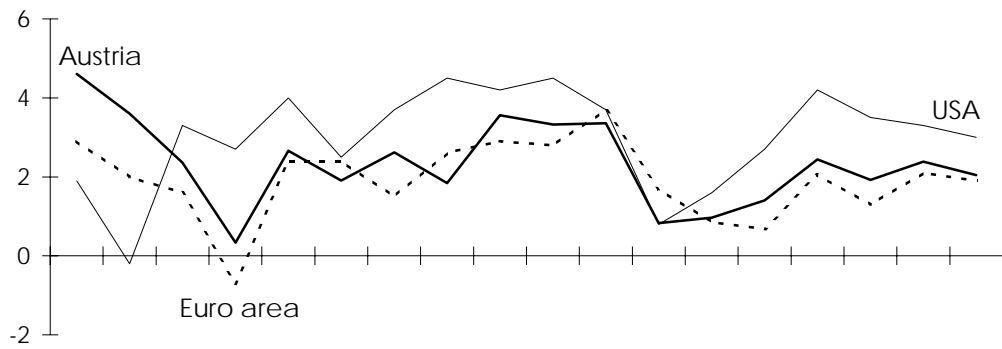
<sup>5</sup> According to Labour Market Service. <sup>6</sup> According to Eurostat Labour Force Survey.

<sup>7</sup> Percent of total labour force excl. self-employed. <sup>8</sup> Percent of population of working age (15 to 64 years).

<sup>9</sup> Changed survey method.

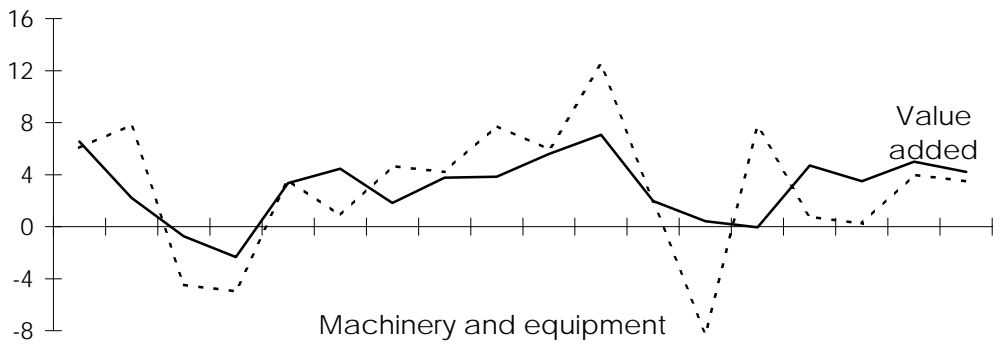
### Growth of real GDP

Percent



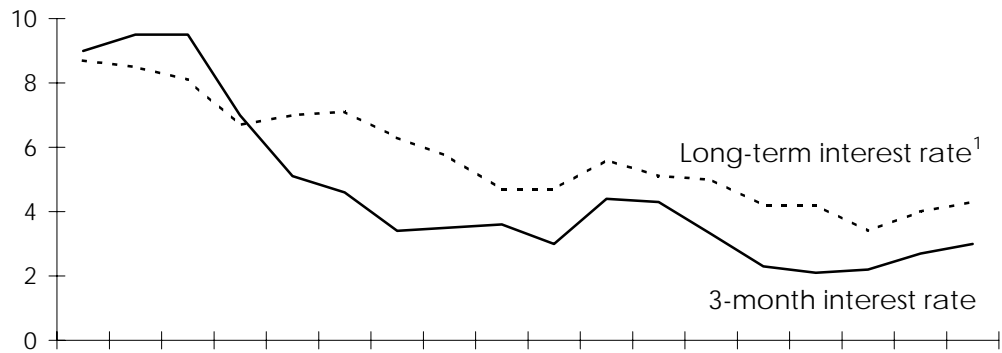
### Manufacturing and investment

Percentage changes from previous year, volume



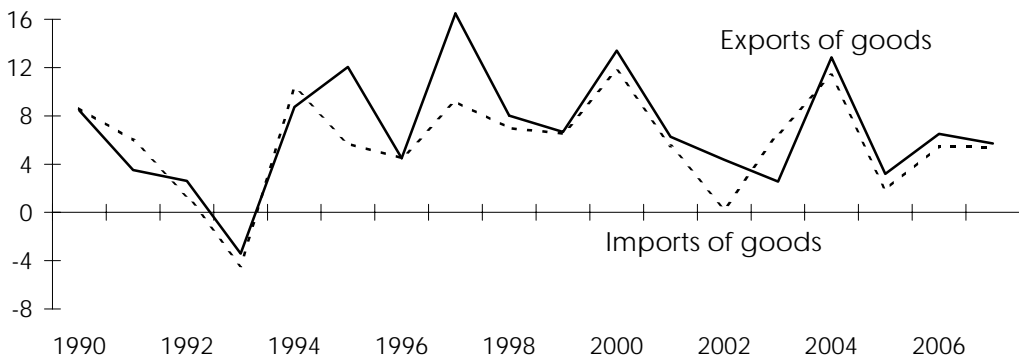
### Short-term and long-term interest rates

Percent



### Trade

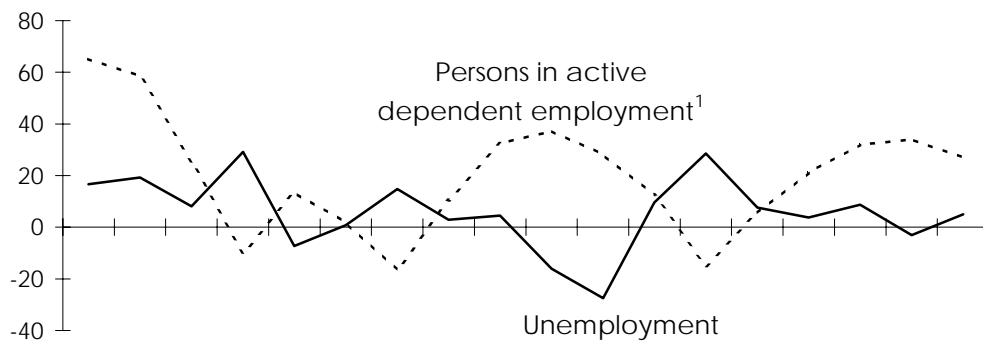
Percentage changes from previous year, volume



<sup>1</sup> 10-year central government bonds (benchmark).

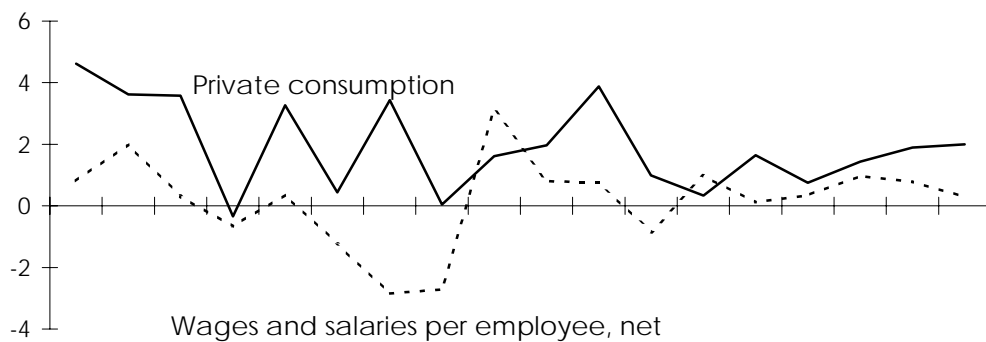
## Employment and unemployment

1,000<sup>s</sup> from previous year



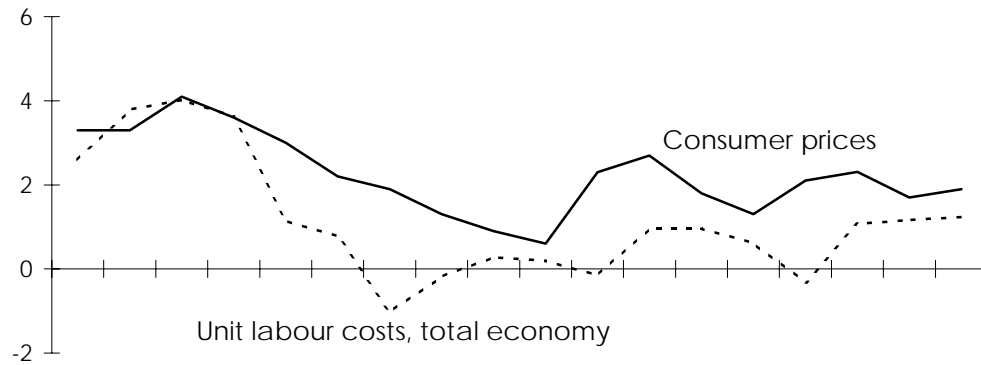
## Consumption and income

Percentage changes from previous year, volume



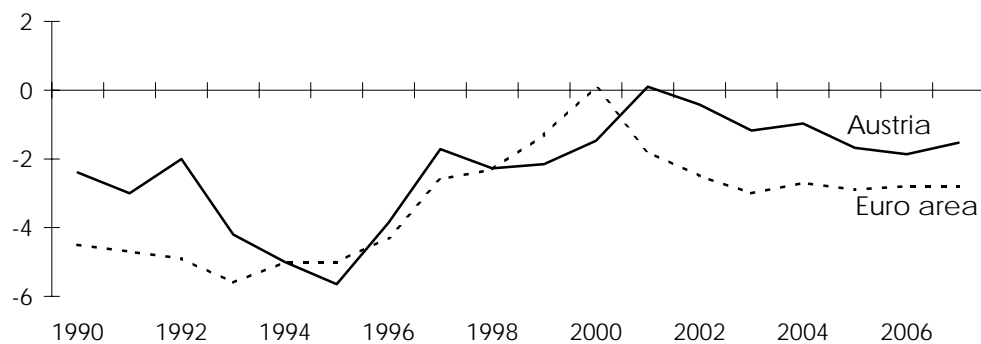
## Inflation and unit labour costs

Percentage changes from previous year



## General government financial balance

As a percentage of GDP



<sup>1</sup> Excluding parental leave, military service, and unemployed persons in training.

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