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Growth Slowing Down Further

Economic Outlook for 2005 and 2006

Economic growth is set to decelerate to a rate of only 1.8 percent this year, with no stronger momentum in sight for 2006, even if the outlook is particularly uncertain at the present juncture. While the stimulus from exports is slackening, consumption and investment are failing to revive. Despite notable employment gains, the strong increase in labour supply is driving unemployment further up. The high price of oil is a major cyclical risk; in conjunction with domestic factors it is pushing headline inflation to a relatively high 2.5 percent this year. The decline of the euro against the dollar should benefit the European export industry.

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Already in its forecast of last spring, WIFO has pointed to the heightened cyclical risks, which now appear more likely to materialise. Growth incentives from exports are fading in the euro area, while internal demand remains lacklustre due to the lack of confidence on the part of consumers and investors alike. The current projections are built upon the assumption of an interest rate cut by the ECB. Overall, however, policy in the euro area appears unable to effectively address the problem of deficient domestic demand and the slow pace of growth. Area-wide GDP is therefore expected to expand by only 1½ percent in volume this year, taking the period of slow growth into its fifth year, interrupted only by short-lived export-induced hiccups. The changing environment during the last three months, with rising oil prices and the euro depreciating against the dollar, should on balance have a slightly positive effect on the euro area and the Austrian economy in a medium-term perspective.

Austria exhibits a similar cyclical pattern as the euro area. Real GDP in the 1st quarter 2005 was 2 percent higher than one year ago, but edged up by a mere 0.2 percent from the previous quarter. Exports and industrial output, the drivers of last year's expansion, are losing momentum. The increase in merchandise exports is expected to narrow to 4.2 percent in volume this year, since aggregate demand in key trading partners like Italy and Germany is tending weaker. Although Austrian exports have in the last years lost some of their important market shares in the new EU member states, they should be able to make up for such losses in the medium term, given their high price competitiveness.

Manufacturing output remained flat in the first quarter 2005 on a seasonally adjusted basis, held back by the slackening of foreign demand. The regular WIFO business survey, while not suggesting a further weakening, does not point to an early recovery of industrial activity. On annual average 2005, production is expected to rise by 3 percent in real terms, which would enable the manufacturing sector to make a major contribution to GDP growth also this year. The slower pace of exports and industrial activity is prompting firms to be more cautious in their investment decisions. Besides, many projects have been carried forward into 2004 for tax reasons. Therefore, investment in machinery and equipment is expected to increase by only 1½ percent this year.

A relatively better performance is observed for the construction sector, which is benefiting from a further increase in funds for the improvement in the transportation infrastructure, notably road construction. Moreover, a recovery of new home construction and renovation activity is in sight. Construction output is projected to gain 2 percent in volume both in 2005 and 2006.

Main results

		2001	2002	2003	2004	2005	2006
		Percentage changes from previous year					
GDP							
Volume		+ 0.7	+ 1.2	+ 0.8	+ 2.2	+ 1.8	+ 1.9
Value		+ 2.5	+ 2.5	+ 2.3	+ 4.1	+ 3.9	+ 3.8
Manufacturing[1], volume		+ 2.2	+ 0.5	+ 0.2	+ 5.1	+ 3.0	+ 3.4
Whole sale and retail trade, volume		+ 2.4	+ 2.2	+ 0.4	+ 1.2	+ 1.5	+ 1.8
Private consumption expenditure, volume		+ 1.0	– 0.1	+ 0.6	+ 1.5	+ 1.5	+ 1.8
Gross fixed investment, volume		– 2.1	– 3.4	+ 6.2	+ 3.6	+ 1.8	+ 2.7
Machinery and equipment[2]		+ 1.6	– 6.5	+ 5.1	+ 7.0	+ 1.5	+ 3.5
Construction		– 5.0	– 0.8	+ 7.0	+ 0.8	+ 2.0	+ 2.0
Exports of goods[3]							
Volume		+ 6.3	+ 4.3	+ 2.5	+13.1	+ 4.2	+ 5.5
Value		+ 6.5	+ 4.2	+ 1.9	+13.9	+ 5.6	+ 6.0
Imports of goods[3]							
Volume		+ 5.5	+ 0.3	+ 6.8	+10.4	+ 2.6	+ 5.0
Value		+ 5.0	– 2.0	+ 5.0	+12.5	+ 4.7	+ 5.7
Current balance	billion €	– 4.13	+ 0.75	– 1.17	+ 0.75	+ 1.57	+ 1.42
As a percentage of GDP	%	– 1.9	+ 0.3	– 0.5	+ 0.3	+ 0.6	+ 0.6
Long-term interest rate[4]	%	5.1	5.0	4.2	4.2	3.3	3.5
Consumer prices		+ 2.7	+ 1.8	+ 1.3	+ 2.1	+ 2.5	+ 1.9
Unemployment rate							
Percent of total labour force[5]	%	3.6	4.2	4.3	4.5	4.6	4.6
Percent of dependent labour force[6]	%	6.1	6.9	7.0	7.1	7.2	7.3
Dependent employment[7]		+ 0.4	– 0.5	+ 0.2	+ 0.7	+ 0.9	+ 0.6
General government financial balance according to Maastricht definition							
As a percentage of GDP	%	+ 0.3	– 0.2	– 1.1	– 1.2	– 1.9	– 1.9

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 Labour Market Service, percent of total labour force excluding self employed. – [7] Excluding parental leave, military service, and unemployed persons in training.

The significant increase in world market prices for crude oil, in conjunction with a number of domestic factors like higher housing costs and the increase in the tobacco tax are driving headline inflation up to a projected 2.5 percent rate. While the rise in inflation has so far cancelled out the positive effects of the tax reform on real disposable income, these effects may start showing up in the second half of the year. Whether the gains in disposable income will lead to higher consumption or higher savings will depend on consumer confidence. On annual average, net real income per employee may edge up by 0.7 percent, having declined by almost 3 percent since 1995. For 2005, WIFO is expecting an increase in consumer spending by 1.5 percent in volume. At the same time, the savings ratio will move up slightly, from 8.9 percent to 9.3 percent of disposable income. On the assumption of moderating oil prices, the rate of inflation may fall to 1.9 percent in 2006. Since, however, the effects of the tax reform will fade, household spending is set to accelerate only marginally to +1¾ percent.

Labour market developments have for the last several years been determined by a strong increase in labour supply. By 2006, the latter will be higher by 150,000 persons than in 2000. This increase is explained by an inflow from the new EU countries and from Germany (with the "Hartz-IV" reforms taking effect), together with a large number of foreign residents being given access to the labour market by acquiring Austrian nationality, and the increase in the early retirement age. The number of people in active employment is rising strongly when compared with the subdued rate of economic growth. In 2006, this number will be higher by over 90.000 than in 2000. In the current year, not only the number of part-time jobs predominantly filled by women is rising, but also that of full-time jobs, many of which are taken by men. New jobs are being created in social services, data processing, personnel rental agencies and in the trade sector. The employment rate will be at 63 percent of the population of working age following the national definition and over 68 percent according to Eurostat. Nevertheless, the rise in employment will not be enough to fully accommodate the higher labour supply, thus leading to higher unemployment. Since 2000, the jobless figure has gone up by 50,000 and is expected to increase by a further 11,000 in 2005 and 2006 combined, to a total of 255,000. The unemployment rate will reach 7.3 percent of the dependent labour force on the traditional national definition, or 4.6 percent of the total labour force according to Eurostat.

Higher corporate profits will boost tax revenues somewhat beyond expectations this year. The general government deficit is projected to remain unchanged at 1.9 percent of GDP next year, reflecting the adverse impact of the cyclical weakness.

Conflicting signals from the cyclical indicators and major uncertainties relating to the data base are at the background of the current assessment. The risks to the forecast are skewed rather towards a weaker outcome than projected, with the outlook for 2006 being particularly vague. The baseline assumption is for GDP growth remaining steady at close to 2 percent. The 2005 tax reform and the "growth package" of early May will provide some stimulus and may contribute towards growth in Austria slightly exceeding the euro area average, both this year and next. In the event, the pace of activity would be clearly higher than for the two most important trading partners, i.e., Germany and Italy, but once again weaker than in the Scandinavian countries.