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# Consumption Offsetting Slackening Austrian Exports

## Economic Outlook for 2016 and 2017

### Consumption Offsetting Slackening Austrian Exports. Economic Outlook for 2016 and 2017

The current sluggishness of the world economy causes a temporary slowdown in Austria's exports. However, domestic private and public consumption rises strongly in 2016 and 2017, lending support to business activity. Gross Domestic Product is projected to expand in both years by 1.6 percent.

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In 2015, the Austrian economy grew only marginally: at +0.9 percent, GDP increased for the fourth time in a row at an annual rate below 1 percent. While investment in machinery and equipment picked up and exports were lively, private consumption barely edged up in the light of high unemployment and subdued income growth.

Demand and output hardly strengthened during the year, as quarterly GDP growth in the last three months was no higher than in the two earlier periods. Yet, the composition of aggregate demand changed: while export growth decelerated due to the international slowdown and also investment lost some momentum, private and public consumption firmed, reflecting the spending on care and accommodation of refugees who had arrived in large numbers during 2015.

The weak underlying dynamics is set to persist in the first half of 2016. Manufacturing companies have lately turned more pessimistic about order levels and business expectations. GDP growth in Austria in 2016 and 2017 should nevertheless prove stronger than in 2015. A major driver is the spending on refugee care, basic subsistence and needs-tested minimum income payments that will boost private as well as public consumption. The tax reform that entered into force in early 2016 will also strengthen private disposable income and spending, even if its impact is partly offset by counter-financing measures. Since the number of newly arriving asylum seekers will likely be lower in 2016 than in 2015, private consumption growth will taper off in 2017, as also the tax reform will no longer provide additional incentives.

The external environment should become more conducive to economic growth in the further course of the year. Activity in the USA remains robust, and the gradual recovery in the euro area continues. The fall in commodity prices has probably bottomed out, such that prospects for the emerging markets are improving. Growth of Austrian exports should thus firm in 2017 and keep demand for new machinery and other investment on a stable upward path. Construction activity, on the other hand,

will stay lacklustre. Overall, GDP is expected to gain 1.6 percent, both in 2016 and 2017.

Table 1: Main results

		2012	2013	2014	2015	2016	2017
		Percentage changes from previous year					
GDP							
Volume		+ 0.8	+ 0.3	+ 0.4	+ 0.9	+ 1.6	+ 1.6
Value		+ 2.7	+ 1.8	+ 2.0	+ 2.4	+ 3.7	+ 3.2
Manufacturing <sup>1</sup> , volume		+ 2.2	- 0.4	+ 1.1	+ 1.1	+ 1.9	+ 2.8
Wholesale and retail trade, volume		- 1.6	- 0.2	- 0.5	+ 1.8	+ 3.2	+ 3.3
Private consumption expenditure, volume		+ 0.6	+ 0.1	+ 0.0	+ 0.4	+ 1.8	+ 1.4
Gross fixed investment, volume		+ 1.3	- 0.3	- 0.2	+ 0.4	+ 1.7	+ 1.8
Machinery and equipment <sup>2</sup>		+ 0.7	- 0.1	+ 1.3	+ 2.8	+ 2.5	+ 2.5
Construction		+ 2.2	- 2.1	- 1.0	- 1.2	+ 0.8	+ 1.3
Other investment <sup>3</sup>		+ 0.2	+ 4.1	- 0.7	+ 0.2	+ 2.2	+ 2.0
Exports of goods <sup>4</sup>							
Volume		+ 0.5	+ 2.9	+ 2.7	+ 2.2	+ 2.7	+ 4.5
Value		+ 1.5	+ 1.8	+ 1.8	+ 2.7	+ 3.0	+ 5.5
Imports of goods <sup>4</sup>							
Volume		- 0.9	- 0.1	+ 1.0	+ 4.0	+ 3.0	+ 4.2
Value		+ 0.7	- 1.0	- 0.7	+ 2.4	+ 2.0	+ 5.8
Current balance	billion €	+ 4.73	+ 6.30	+ 6.49	+ 9.11	+10.73	+11.41
As a percentage of GDP		+ 1.5	+ 1.9	+ 2.0	+ 2.7	+ 3.1	+ 3.2
Long-term interest rate <sup>5</sup>	percent	2.4	2.0	1.5	0.7	0.8	1.1
Consumer prices		+ 2.4	+ 2.0	+ 1.7	+ 0.9	+ 1.2	+ 1.8
Unemployment rate							
Eurostat definition <sup>6</sup>	percent	4.9	5.4	5.6	5.7	5.9	6.1
National definition <sup>7</sup>	percent	7.0	7.6	8.4	9.1	9.5	9.8
Persons in active dependent employment <sup>8</sup>		+ 1.4	+ 0.6	+ 0.7	+ 1.0	+ 1.2	+ 1.2
General government financial balance according to Maastricht definition							
As a percentage of GDP		- 2.2	- 1.3	- 2.7	- 1.4	- 1.7	- 1.5

Source: WIFO. 2016 to 2017: forecast. – <sup>1</sup> Value added, including mining and quarrying. – <sup>2</sup> Including weapon systems. – <sup>3</sup> Intellectual property products and cultivated biological resources. – <sup>4</sup> According to Statistics Austria. – <sup>5</sup> 10-year central government bonds (benchmark). – <sup>6</sup> According to Eurostat Labour Force Survey. – <sup>7</sup> According to Public Employment Service Austria, as a percentage of total labour force excluding self employed. – <sup>8</sup> Excluding parental leave, military service.

Employment will continue to expand markedly over the forecast period. The increasing population of working age, fuelled also by refugee immigration, the rise in the effective retirement age and in female labour force participation will all add to labour supply. With the latter outpacing labour demand, unemployment will climb further to rates of 9.5 percent and 9.8 percent of the dependent labour force in 2016 and 2017, respectively.

The dampening effect of cheap oil on inflation is likely to fade out by the end of 2016. At the same time, the measures to counter-finance the tax reform will show up in consumer prices. Private earnings, however, are unlikely to exert any substantial inflationary pressure, given the high level of unemployment. WIFO expects the consumer price index to move up by an annual average 1.2 percent in 2016 and by 1.8 percent in 2017.

Government budgets will still be burdened by financial support for banks in distress, but probably less so than in the last few years. On the other hand, care and accommodation of refugees will put new claims on public expenditure. The tax reform will cause sizeable losses in wage and income tax revenues, which shall be compensated by the counter-financing measures on the revenue and the expenditure side, which were adopted together with the reform. Offsetting the spending over-

runs in 2015 have been buoyant tax revenues and lower-than-budgeted retirement and interest expenditure. The general government deficit (Maastricht definition) narrowed from 2.7 percent of GDP in 2014 to 1.4 percent in 2015. WIFO projects the deficit ratio to edge up to 1.7 percent of GDP, abating to 1.5 percent in 2017.

## 1. Global economic activity losing some momentum

Growth of the world economy lost steam in the second half of 2015. US GDP in the fourth quarter gained only 0.3 percent from the previous period, down from +0.5 percent in the third quarter. Activity was driven by private consumption, which remained buoyant also in the last three months of the year, benefiting from receding unemployment and the steady increase in real estate prices. Investment, however, weakened markedly towards the end of 2015, which was probably related to the diminishing profitability of investments in oil and gas extraction facilities in the face of the current low commodity prices. Exports also fell, due to the persistently strong exchange rate and low demand from emerging market countries.

Several indicators point to subdued activity extending into early 2016. Although the Institute for Supply Management (ISM) Purchasing Managers' Index edged up in January, it is still way below the threshold of expansion. Consumer confidence dropped again slightly in February, but private demand should nevertheless stay robust on the back of favourable labour market conditions. WIFO expects US GDP growth at 2 percent for 2016 and 2.4 percent for 2017.

The US Central Bank ended its zero-interest-rate policy in December 2015 raising the key rate by 25 basis points, the first increase since the onset of the financial market and economic crisis. The move was mainly motivated by the low unemployment rate. Inflation has also been heading up lately: core inflation (excluding food and energy) as the crucial benchmark for domestic price pressure stood above an annual 2 percent in January. The Fed may thus tighten the monetary reins further, albeit in a cautious way in view of slackening business activity.

The transformation of the Chinese economy from export-led growth towards more domestically-driven expansion has been accompanied by a steady deceleration of GDP growth. For the first time in several years, GDP advanced by less than 7 percent in 2015. Price competitiveness of Chinese goods has been declining for some time, as a result of strong wage growth triggered by the booming activity. In addition, the Chinese currency has been appreciating since 2014, prompting firms to relocate production towards other countries. The government has tried to cushion the slow-down by growth-supportive policy measures. Still, the situation on credit and real estate markets remains fragile. Also large-scale public investment in infrastructure and residential construction is approaching a ceiling. Against this background, WIFO expects a further deceleration of GDP growth to an annual 6.2 percent in 2016 and 5.8 percent in 2017.

Many emerging market economies still suffer from the slump in commodity prices. The reference price for crude oil (Brent) hovered around 30 \$ per barrel in February, up from 26 \$ temporarily registered in January. Also the quotations for agricultural and industrial raw materials have followed a downward trend since 2014. The main reason is seen in sluggish global growth and lower demand for raw materials from China. Moreover, many oil-exporting countries have strongly increased supply. The price slump has grave consequences for the commodity-exporting transition economies like Brazil and Russia which both are caught in recession.

Raw material prices are likely to remain under downward pressure, also in view of the fact that the revocation of the economic sanctions against Iran will raise oil supply on world markets. Hence, emerging markets can expect only moderate economic growth over the forecast period.

*Although GDP growth in the USA slowed down towards the end of 2015, business activity should prove resilient. In China, the structural transformation of the economy is weighing on growth, while many emerging markets suffer from the slump in commodity prices.*

## 2. Activity in the euro area remains muted

Economic activity in the euro area keeps lacking momentum. In the last three months of 2015 GDP rose by 0.3 percent quarter-on-quarter, the same rate as in the previous period. The cyclical pace remained low in Germany and France and weakened slightly in Italy. Among the larger member countries, only Spain enjoyed solid growth. In most euro area countries, domestic demand is providing major support while exports are slackening or even receding in a quarterly comparison, like in Germany.

*The euro area is set to continue its tentative cyclical recovery, while confidence among consumers and companies remains fragile.*

Table 2: World economy

	2012	2013	2014	2015	2016	2017
	Percentage changes from previous year					
<i>Real GDP</i>						
World	+ 3.5	+ 3.2	+ 3.3	+ 3.1	+ 3.1	+ 3.4
USA	+ 2.2	+ 1.5	+ 2.4	+ 2.4	+ 2.0	+ 2.4
Japan	+ 1.7	+ 1.4	± 0.0	+ 0.5	+ 0.8	+ 1.2
EU 28	- 0.5	+ 0.2	+ 1.4	+ 1.9	+ 1.6	+ 1.8
Euro area 19	- 0.9	- 0.3	+ 0.9	+ 1.6	+ 1.4	+ 1.6
CEEC 5 <sup>1</sup>	+ 0.4	+ 0.9	+ 3.0	+ 3.5	+ 3.1	+ 3.2
China	+ 7.7	+ 7.7	+ 7.3	+ 6.9	+ 6.2	+ 5.8
World trade, volume	+ 1.6	+ 2.4	+ 3.2	+ 2.5	+ 2.0	+ 2.5
Market growth <sup>2</sup>	+ 0.6	+ 1.8	+ 3.5	+ 2.5	+ 3.0	+ 4.5
<i>Primary commodity prices<sup>3</sup></i>						
HWI index, total	- 2.8	- 1.9	- 7.0	- 41.5	- 26	+ 16
Excluding crude oil	- 14.4	- 6.1	- 6.2	- 19.6	- 6	+ 8
<i>Crude oil prices</i>						
Brent, \$ per barrel	111.6	108.7	99.0	52.5	35	42
<i>Exchange rate</i>						
\$ per €	1.286	1.328	1.329	1.110	1.10	1.10

Source: WIFO. 2016 to 2017: forecast. – <sup>1</sup> Czech Republic, Hungary, Poland, Slovakia, Slovenia. – <sup>2</sup> Real import growth of goods of trading partners weighted by Austrian export shares. – <sup>3</sup> Dollar.

The regular business survey conducted by the European Commission suggests that the sluggish trend will persist. In February, business confidence in the euro area dropped in all sectors except construction. After a temporary upturn, the Economic Sentiment Indicator (ESI) fell back to the level held in summer 2015, staying below its long-term average. The outlook weakened in all major countries of the euro area. Confidence dropped most among consumers and industrial manufacturers who turned more pessimistic with regard to their order situation and output expectations. Overall, the ESI points to modest growth early this year and little acceleration over the forecast horizon.

In the face of disinflation or even negative inflation rates, the European Central Bank is taking expansionary measures to sustain business activity. Since March 2015, the Bank has been purchasing government bonds to the tune of 60 billion € per month. The programme is due to end in March 2017, but may be extended if deemed necessary. On 10 March 2016, the ECB Governing Council decided to include corporate bonds into the purchasing programme as of April 2016 and to raise the volume to 80 billion € per month. The interest rate on banks' deposits with the Central Bank was cut once again to currently -0.4 percent, in an effort to encourage banks to higher lending. The expansionary stance pursued by the ECB in contrast with interest rates heading up in the USA will keep the euro exchange rate low. Beyond that, the measures are unlikely to provide substantial stimulus to business activity. Likewise, the projects carried out under the auspices of the European Fund for Strategic Investment (EFSI) will raise demand only gradually and in total will not suffice to stimulate economic activity markedly.

However, the low price of energy commodities and raw materials, the tentative reversal of rising unemployment and a less restrictive fiscal stance than in previous

years should support overall demand in the euro area. WIFO expects GDP growth at 1.4 percent for 2016, edging up to 1.6 percent in 2017.

### 3. Consumption growth offsetting slackening Austrian exports

In 2015, Austria's GDP rose by 0.9 percent, for the fourth consecutive year at a rate below 1 percent. In the course of the year, activity hardly strengthened, the quarterly rate from October to December of 0.3 percent was no higher than in the two earlier periods. While investment in machinery and equipment picked up from the previous year in 2015 and foreign trade provided strong incentives, private consumption remained broadly flat.

Nevertheless, the composition of overall demand shifted somewhat towards the end of the year: export growth slackened markedly in the fourth quarter due to the global slowdown and investment lost slightly momentum, but consumption rose significantly, driven by a considerable increase in final consumption expenditure of non-profit institutions serving households and government. This reflects the outlays for basic care and subsistence payments for refugees, the number of which had risen massively during 2015. However, private consumption in the narrower sense – without non-profit institutions serving households – hardly picked up in the last three months of the year, as neither the low energy prices nor the prospect of higher net incomes on account of the tax reform 2016 encouraged private households to step up their spending. Continued high unemployment, moderate wage growth and higher cost of housing and services probably induced them to greater caution.

The underlying cyclical weakness is set to persist in the current year. According to the WIFO survey conducted in February, business confidence has softened markedly and also the WIFO Leading Indicator dropped significantly. Especially manufacturing companies turned more pessimistic in the light of slower global growth. The reading of the consumer confidence indicator released by the European Commission showed a slight improvement. The widespread sluggishness is countered, however, by higher outlays for refugees which is reflected in higher private and public consumption. The number of applications for asylum climbed strongly during 2015 to a total of nearly 90,000 – a plus of 60,000 from the previous year. In early 2016, the pace slowed down somewhat, with almost 6,000 new cases opened in January. Moreover, the government has announced its intention to clearly limit the number of new asylum applications in 2016 and thereafter. On the basis of current settings, WIFO anticipates 70,000 new applications for asylum in 2016 and 35,000 in 2017.

During the processing of their applications, asylum seekers receive primary care and, once granted asylum or being entitled to subsidiary protection, needs-tested minimum income. The cost of basic subsistence care is defined by regulation and is borne by the public authorities. Since the care in many cases is taken over by private aid organisations or church communities, part of the cost is included in consumption of non-profit institutions serving households. The larger part of applications for asylum filed in 2015 is still being processed. Thus, the number of persons receiving basic subsistence care will decline only gradually. For 2016, WIFO expects a full-time equivalent of 55,000 asylum seekers in basic subsistence care, and of 30,000 for 2017. The needs-tested minimum income mainly serves to cover basic personal needs and is part of private consumption which thereby increases noticeably over the forecast period.

In 2016, private consumption is also supported by the wage and income tax reform that took effect at the beginning of the year, implying substantial gains in net earnings. If all planned counter-financing measures are actually implemented, private consumption will be raised by about 0.4 percent on account of the reform<sup>1</sup>. Overall, WIFO projects an increase in private consumption by 1.8 percent in 2016 and

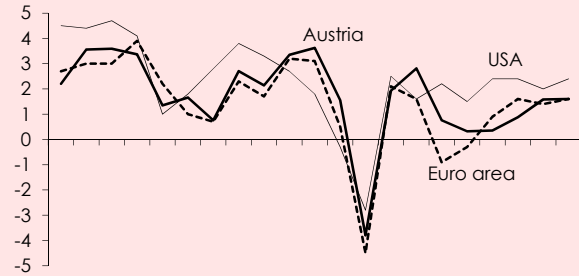
*Expenditure on accommodation and care of refugees is boosting private and public consumption in Austria, thereby cushioning the dampening impact of the global cyclical slowdown.*

<sup>1</sup> Baumgartner, J., Kaniowski, S., "Tax Reform 2015-16 – Macroeconomic Effects up to 2019", WIFO Bulletin, 2015, 20(22), pp. 250-265, <http://bulletin.wifo.ac.at/58374>.

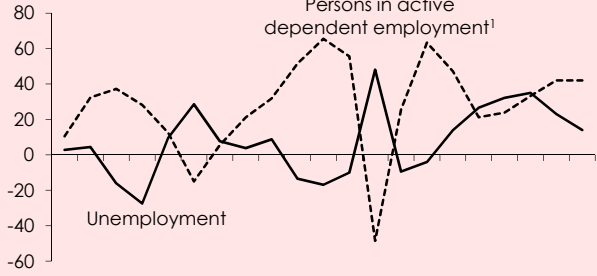
1.4 percent in 2017. Public consumption will likewise increase (2016 +0.8 percent, 2017 +0.7 percent).

Figure 1: Indicators of economic performance

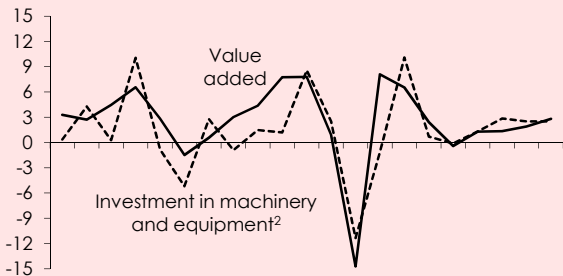
Growth of real GDP  
Percent



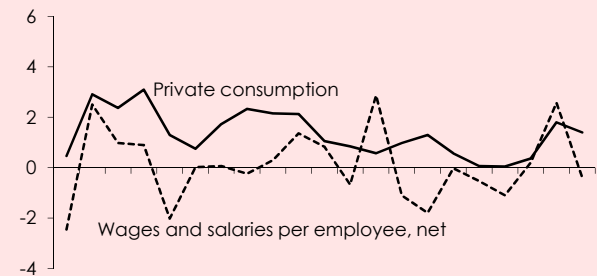
Employment and unemployment  
1,000 from previous year



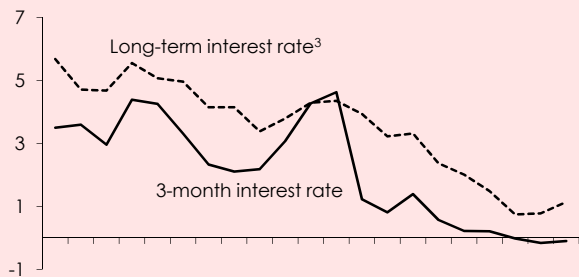
Manufacturing and investment  
Percentage changes from previous year, volume



Consumption and income  
Percentage changes from previous year, volume



Short-term and long-term interest rates  
Percent



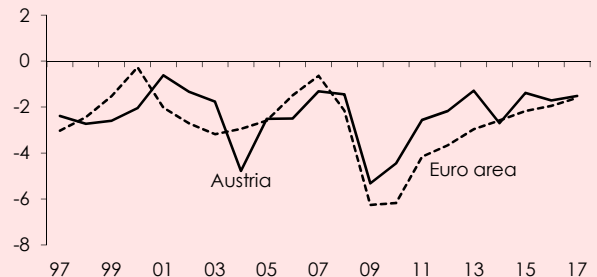
Inflation and unit labour costs  
Percentage changes from previous year



Trade  
Percentage changes from previous year, volume



General government financial balance  
As a percentage of GDP



Source: WIFO. 2016 to 2017: forecast. – <sup>1</sup> Excluding parental leave, military service, and unemployed persons in training. – <sup>2</sup> 10-year central government bonds (benchmark).

Table 3: Private consumption, income and prices

	2012	2013	2014	2015	2016	2017
	Percentage changes from previous year, volume					
Private consumption expenditure	+ 0.6	+ 0.1	+ 0.0	+ 0.4	+ 1.8	+ 1.4
Durables	+ 0.7	- 3.0	- 0.5	- 1.5	+ 2.0	+ 2.5
Non-durables and services	+ 0.5	+ 0.4	+ 0.1	+ 0.6	+ 1.8	+ 1.3
Household disposable income	+ 2.0	- 2.0	+ 0.5	+ 0.6	+ 2.3	+ 1.5
	As a percentage of disposable income					
Household saving ratio						
Including adjustment for the change in net equity of households in pension fund reserves	9.2	7.3	7.8	8.0	8.4	8.5
Excluding adjustment for the change in net equity of households in pension fund reserves	8.5	6.6	7.0	7.2	7.6	7.7
	Percentage changes from previous year					
Direct lending to domestic non-banks <sup>1</sup>	+ 0.0	- 1.2	+ 0.3	+ 2.0	+ 2.3	+ 2.4
	Percentage changes from previous year					
Inflation rate						
National	2.4	2.0	1.7	0.9	1.2	1.8
Harmonised	2.6	2.1	1.5	0.8	1.2	1.8
Core inflation <sup>2</sup>	2.3	2.3	1.9	1.7	1.7	1.6

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

Table 4: Earnings and international competitiveness

	2012	2013	2014	2015	2016	2017
	Percentage changes from previous year					
Gross earnings per employee <sup>1</sup>	+ 2.7	+ 1.9	+ 1.4	+ 1.7	+ 1.3	+ 1.5
Gross real earnings per employee <sup>2</sup>	+ 0.3	- 0.1	- 0.3	+ 0.8	+ 0.1	- 0.3
Net real earnings per employee <sup>2</sup>	- 0.0	- 0.5	- 1.1	+ 0.2	+ 2.6	- 0.4
Unit labour costs						
Total economy	+ 3.0	+ 2.2	+ 2.2	+ 1.4	+ 0.9	+ 1.2
Manufacturing	+ 2.7	+ 2.5	+ 1.2	+ 0.9	- 0.4	- 1.0
Effective exchange rate, manufactures						
Nominal	- 1.7	+ 1.8	+ 1.2	- 2.7	+ 1.1	+ 0.1
Real	- 1.7	+ 2.1	+ 1.5	- 2.7	+ 1.3	- 0.3

Source: WIFO. 2016 to 2017: forecast. – <sup>1</sup> Employees according to National Accounts definition. – <sup>2</sup> Deflated by CPI.

### 3.1 Exports and equipment investment shaped by external business conditions

Gross fixed capital formation gathered momentum as from spring 2015 which was broadly maintained until the end of the year. The steadily brightening business expectations prompted firms to spend more on the renewal of productive capacities. Lately, however, the clouding global environment undermined corporate confidence; notably manufacturers expressed scepticism with regard to their order levels and the short-term outlook. Thus, companies are likely to tread more carefully in spending on new equipment in the next few months. WIFO nevertheless expects a solid increase in investment in machinery and equipment and other investment over the forecast horizon.

Construction investment suffered the third year-on-year decline in a row in 2015. Nevertheless, opinions expressed by firms in the regular WIFO Business Cycle Survey improved markedly during the year, boding well for an expansion of construction activity in 2016 and 2017. Residential construction in particular should be fuelled by population growth. The federal government's "housing campaign" and the planned foundation of a residential investment bank (Wohnbauinvestitionsbank, WBIB) should provide demand incentives mainly in 2017. Overall, gross fixed investment is pro-



jected to increase by an annual 1.7 percent and 1.8 percent in 2016 and 2017, respectively.

In 2015, Austria's foreign trade was shaped by sluggish economic growth in the euro area and the emerging markets. Demand was livelier from the USA and from the neighbours in East Central Europe. Exports to both regions decelerated nevertheless during the year, and the more gloomy international environment markedly dampened deliveries abroad in the fourth quarter. While the pace may remain modest in the first few months of 2016, exports should prove robust on the whole over the projection period. As business activity picks up in key foreign markets, Austrian exports will regain strength. WIFO expects merchandise exports to expand by 2.7 percent in volume from the previous year in 2016, and by 4.5 percent in 2017. Assuming robust growth in machinery and equipment investment and a rebound in private consumption, imports of goods are projected to gain 3 percent in 2016 and 4.2 percent in 2017.

The Austrian tourism industry enjoyed a highly successful year 2015. In the last three months of 2015, however, growth came to a halt as tourist travel exports stagnated from the previous quarter. Major reasons have probably been the lack of snow in the earlier part of the winter season and travelling obstacles deriving from the re-introduction of border controls between Germany and Austria. Tourism exports are projected to expand further in 2016 and 2017, albeit at a lower rate than in 2015. Substantially better snow conditions since January and the early date of Easter holidays have given a boost to winter tourism early this year. Positive incentives may also result from precarious security conditions in some major destinations of European travellers and from the massive inflow of refugees in Greece if they lead to deviations in tourism flows in favour of Austria.

The Austrian manufacturing sector benefited from a rebound of domestic investment and lively foreign demand in 2015. Gross value added expanded significantly between April and December. Going forward, manufacturing output is projected to stay on a firm upward path, rising by 1.9 percent in 2016 and 2.8 percent in 2017. Gross value added should expand even faster in the retail sector, by more than 3 percent per year, driven by buoyant consumer spending.

*After a temporary slackening in the first half of 2016, exports are set to resume a firm upward trend. Also investment in machinery and equipment and other investment will stay robust, whereas growth is likely to be subdued in the construction sector.*

Table 5: Productivity

	2012	2013	2014	2015	2016	2017
	Percentage changes from previous year					
<i>Total economy</i>						
Real GDP	+ 0.8	+ 0.3	+ 0.4	+ 0.9	+ 1.6	+ 1.6
Hours worked <sup>1</sup>	- 0.3	- 0.5	+ 0.4	+ 0.4	+ 0.9	+ 0.9
Productivity per hour	+ 1.1	+ 0.8	- 0.1	+ 0.5	+ 0.7	+ 0.7
Employment <sup>2</sup>	+ 1.1	+ 0.6	+ 1.1	+ 0.5	+ 1.2	+ 1.3
<i>Manufacturing</i>						
Production <sup>3</sup>	+ 2.4	- 0.4	+ 1.3	+ 1.3	+ 1.9	+ 2.8
Hours worked <sup>1</sup>	+ 1.1	- 0.7	- 0.0	+ 0.1	± 0.0	± 0.0
Productivity per hour	+ 1.2	+ 0.3	+ 1.3	+ 1.2	+ 1.9	+ 2.8
Employees <sup>1</sup>	+ 1.5	- 0.3	+ 0.2	- 0.2	- 0.1	± 0.0

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

### 3.2 No relief in labour market conditions

Despite weak economic activity, employment increased markedly in the last twelve months, particularly in services, while remaining broadly flat in manufacturing and construction. In February 2016, the number of persons in dependent active employment was 60,000 or 1.8 percent higher than one year ago. Due to clement weather conditions, employment in the construction sector largely contributed to the strong increase. Nevertheless, unemployment also went up, by 8,100 persons or 2 percent, even if, on a seasonally-adjusted basis, the rate of unemployment has remained constant since May 2015.

The labour market situation is unlikely to improve over the forecast horizon. Although dependent active employment is expected to grow by 42,000 persons or 1.2 per-

*Unemployment is set to remain upward bound over the forecast period, as labour demand cannot fully absorb the increase in labour supply.*



cent each in 2016 and 2017, labour supply will expand markedly, too. Main drivers are an increase in the population of working age, due inter alia to the inflow of refugees, the rising effective retirement age and a higher female employment ratio. The jobless rate on national (Public Employment Service) definition will thus climb to 9.5 percent in 2016 and 9.8 percent in 2017.

Table 6: Labour market

		2012	2013	2014	2015	2016	2017
		Changes from previous year, in 1,000					
<i>Demand for labour</i>							
Persons in active employment <sup>1</sup>		+ 50.1	+ 29.3	+ 31.8	+ 38.2	+ 47.0	+ 47.0
Employees <sup>2</sup>		+ 47.2	+ 21.2	+ 23.8	+ 33.2	+ 42.0	+ 42.0
Percentage changes from previous year		+ 1.4	+ 0.6	+ 0.7	+ 1.0	+ 1.2	+ 1.2
Nationals		+ 9.0	- 8.5	- 8.1	+ 6.3	+ 9.0	+ 9.0
Foreign workers		+ 38.1	+ 29.7	+ 32.0	+ 27.0	+ 33.0	+ 33.0
Self-employed <sup>3</sup>		+ 2.9	+ 8.1	+ 8.0	+ 5.0	+ 5.0	+ 5.0
<i>Labour supply</i>							
Population of working age	15 to 64 years	+ 18.0	+ 23.5	+ 33.1	+ 44.4	+ 37.8	+ 34.2
	15 to 59 years	+ 22.3	+ 27.2	+ 33.7	+ 36.4	+ 22.5	+ 15.2
Labour force <sup>4</sup>		+ 64.0	+ 55.9	+ 64.0	+ 73.2	+ 70.0	+ 61.0
<i>Surplus of labour</i>							
Registered unemployed <sup>5</sup>		+ 13.9	+ 26.6	+ 32.2	+ 35.0	+ 23.0	+ 14.0
In 1,000		260.6	287.2	319.4	354.3	377.3	391.3
Unemployed persons in training <sup>5</sup>	in 1,000	66.6	73.5	75.3	65.1	73.1	81.1
		In percent					
Unemployment rate							
Eurostat definition <sup>6</sup>		4.9	5.4	5.6	5.7	5.9	6.1
As a percentage of total labour force <sup>5</sup>		6.2	6.8	7.4	8.1	8.5	8.7
National definition <sup>5,7</sup>		7.0	7.6	8.4	9.1	9.5	9.8
Employment rate							
Persons in active employment <sup>1,8</sup>		67.2	67.5	67.6	67.8	68.1	68.5
Total employment <sup>6,8</sup>		71.4	71.4	71.1	71.2	71.5	71.8

Source: WIFO. 2016 to 2017: forecast. – <sup>1</sup> Excluding parental leave, military service. – <sup>2</sup> According to Federation of Austrian Social Security Institutions. – <sup>3</sup> According to WIFO. – <sup>4</sup> Persons in active employment plus unemployment. – <sup>5</sup> According to Public Employment Service Austria. – <sup>6</sup> According to Eurostat Labour Force Survey. – <sup>7</sup> As a percentage of total labour force, excluding self-employed. – <sup>8</sup> As a percentage of population of working age (15 to 64 years).

### 3.3 Inflation gradually heading up again

Weak demand worldwide and buoyant supply have caused a fall in world market raw material quotations which dampens the rise in consumer prices. Hence, the annual rate of inflation fell to 0.9 percent in 2015, still being significantly above the rate in Germany and the euro area average, on account of strong price hikes for catering services, housing rents and insurance services.

The present forecast assumes that the oil prices have bottomed out in January 2016 and will trend up over the projection period. The dampening effect on the overall inflation rate will last until the end of 2016, though becoming weaker from month to month. The difficult labour market conditions should keep real wages flat into 2017 which, together with further productivity gains, will prevent upward pressure on prices. However, a number of measures taken in the context of the tax reform will boost inflation in 2016. Higher indirect taxes and measures to prevent tax evasion and fraud are likely to raise consumer prices<sup>2</sup>. On the other hand, the adjustment of the reference value for housing rents will be suspended in 2016, the following adjustment being due in April 2017. WIFO projects annual headline inflation at 1.2 percent for 2016 and 1.8 percent for 2017.

Once the dampening impact of lower oil prices has faded, inflation is likely to head up again. Still, headline inflation will remain well below the 2 percent benchmark.

<sup>2</sup> According to WIFO calculations, the inflationary effect of the tax reform amounts to +0.3 percentage points in 2016 and +0.2 percentage points in 2017 (Baumgartner, J., Kaniovski, S., "Tax Reform 2015-16 – Macroeconomic Effects up to 2019", WIFO Bulletin, 2015, 20(22), pp. 250-265, <http://bulletin.wifo.ac.at/58374>).

### 3.4 Benign fiscal developments partly offsetting one-off budgetary burdens

In spite of sizeable budgetary burdens, government households performed altogether well in 2015. Revenues from assessed income tax, property transfer tax and capital gains tax increased strongly, while expenditure on retirement benefits were lower than anticipated and low refinancing cost led once again to lower interest spending on government debt. On the other hand, subsidies for banks in distress and the resolution of HETA required a total of 2.1 billion €. On preliminary estimates, the general government balance (Maastricht definition) exhibited a deficit equivalent to 1.4 percent of GDP, significantly lower than expected. Abstracting from the support for banks, the deficit would have been no higher than 0.8 percent of GDP. On account of the subsidies to the financial sector, overall government debt was pushed up by a cumulated 35.7 billion € or 10.6 percent of GDP between 2008 and 2015<sup>3</sup>.

Financial support for banks will continue to strain the budget balance over the forecast period, albeit to a lesser extent than so far. The projection assumes subsidies amounting to 700 million € in 2016 and to 500 million € in 2017. The tax reform that entered into force in early 2016 implies losses in wage and assessed income tax revenues of around 4 billion € (1.1 percent of GDP) in the first year and of 5.4 billion € p.a. (1.5 percent of GDP) as from 2017. An array of measures are envisaged in order to compensate the revenue losses, by raising additional revenue from various tax hikes and from the fight against tax fraud and abuse of social benefits. Moreover, the federal and the Länder governments are supposed to cut subsidies and administrative cost by 1.1 billion €. The forecast rests on the assumption that the measures concerning the federal government have been included in the draft federal budget for 2016 and will be implemented in due time.

*The budgetary costs of subsidies for banks in distress and care and accommodation of refugees are partly offset by buoyant revenues from taxes and social security contributions and by lower-than-planned retirement and interest expenditure. The general government deficit will stay well below 2 percent of GDP.*

Table 7: Key policy indicators

	2012	2013	2014	2015	2016	2017
	As a percentage of GDP					
<i>Fiscal policy</i>						
General government financial balance						
According to Maastricht definition	- 2.2	- 1.3	- 2.7	- 1.4	- 1.7	- 1.5
General government primary balance	0.6	1.3	- 0.2	0.9	0.5	0.6
	In percent					
<i>Monetary policy</i>						
3-month interest rate	0.6	0.2	0.2	- 0.0	- 0.2	- 0.1
Long-term interest rate <sup>2</sup>	2.4	2.0	1.5	0.7	0.8	1.1
	Percentage changes from previous year					
<i>Effective exchange rate</i>						
Nominal	- 1.5	+ 1.7	+ 1.2	- 2.8	+ 1.1	+ 0.1
Real	- 1.5	+ 2.1	+ 1.5	- 2.6	+ 1.2	- 0.3

Source: WIFO. 2016 to 2017: forecast. – <sup>1</sup> 10-year central government bonds (benchmark).

Further strain on government budgets derives from the accommodation and basic subsistence of refugees, implying an increase in both public consumption and other current transfers. The additional expenditure on needs-tested minimum income for recognised refugees and beneficiaries of subsidiary protection is mirrored by an increase in social benefits other than social transfers in kind. Further cost arises from integration measures and from provisions for legal enforcement and public security. On the basis of the assumptions underlying the present forecast (see above), the

<sup>3</sup> Schratzenstaller, M., "Fiscal Policy Facing Major Challenges with Tax Reform, Need for Growth-Enhancing Investment and Consolidation Targets. Federal Fiscal Framework 2016-2019 and Draft Federal Budget 2016", WIFO Bulletin, 2016, 21(2), pp. 12-29, <http://bulletin.wifo.ac.at/58717>; Fiskalrat, Das "österreichische Bankenpaket" und die Staatsfinanzen, Vienna, 2016, <https://fiskalrat.at/dam/jcr:55ec2359-ac1b-4cef-8506-6c8c7dfdcd34/FISK-Info-extern-Bankenpaket.pdf>.

expenditure on refugee care and accommodation will total 1.9 billion € in 2016 and 1.8 billion € in 2017<sup>4</sup>.

The fiscal burden arising from the inflow of refugees has to be set against the impact of the benign factors referred to above. Public debt service cost is likely to remain low throughout the projection period. Likewise, buoyant tax revenues and lower-than-anticipated retirement spending will exonerate the budget balance in 2016 and 2017. Tax revenues will also be boosted by the significant increase in private consumption. In all, WIFO expects the general government deficit (Maastricht definition) edging up to 1.7 percent of GDP in 2016 before abating to 1.5 percent of GDP in 2017. Government debt would in the event head down to 84.3 percent of GDP in 2016 and 83 percent of GDP in 2017.

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#### 4. Risks to the forecast

The uncertainties surrounding the immigration of refugees represent the major risk to the present forecast. The assumption on the number of applications for asylum is guided by the trend observed in the first few weeks of 2016. Actual developments, however, will depend on many factors that are difficult to assess from today's perspective. The closing of the "Balkan route", for example, has led to an important tail-back of refugees in Greece who will have to be registered and allocated across other countries. The number of persons trying to escape from their home countries to the EU is likely to remain high and may rebound once weather conditions improve. Whether the EU will reach an agreement with Turkey on the acceptance of refugees in the next few weeks, the details of such an agreement and the repercussions on the number of refugees arriving in Austria are all unclear to date. In view of this wide margin of uncertainty, the present forecast can only work on tentative assumptions on the number of applications for asylum filed in Austria.

Risks for government finances also arise from the necessary support for ailing banks. It is further unclear to what extent the budgeted additional revenues of 1.9 billion € from the fight against tax fraud and social benefit abuse will actually accrue already in 2016.

Still other risks emanate from developments in the global economy. Thus, the slow-down of activity in the USA may turn out sharper than expected. It is also unclear how smoothly the Chinese economy can manage the desired structural shift towards a greater consumption-based domestic demand structure. This process may be accompanied by repeated turbulence on financial markets and in the real economy. Uncertainty finally relates to the further course of US monetary policy. Whether in the face of the cyclical slowdown the Fed will actually proceed with the announced gradual increase in interest rates, remains to be seen.

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<sup>4</sup> The estimated figures refer to the total amount of outlays rather than to their increase from the previous year.