

Marcus Scheiblecker

Cyclical Upturn Gaining Full Momentum – Solid Growth also in 2007

Economic Outlook for 2006 and 2007

As from the second semester 2005, favourable business conditions worldwide have set in motion a cyclical upswing in Austria, which has been gaining strength in the current year. Demand incentives have been transmitted from exports to domestic investment, thereby fostering the sustainability of the upturn. Slackening external demand, partly related to one-off factors in Germany, will slow the overall pace of growth in 2007, although internal demand will benefit from a revival of private consumption.

All staff members of the Austrian Institute of Economic Research contribute to the Economic Outlook. • Cut-off date: 4 October 2006. • E-mail address: Marcus.Scheiblecker@wifo.ac.at

WIFO at present sees the short-term economic outlook for Austria markedly more positive than at the time of its last forecast at the end of June. For 2006, GDP growth is revised upwards by ½ percentage point to a rate of 3.1 percent, the projection for 2007 is for a rate of 2.5 percent. In both years, growth would thereby remain above the euro area average. Domestic business fixed investment has picked up much more strongly than expected three months ago, with a likely increase by 5 percent in volume for the year as a whole. Demand is lively for both machinery and equipment as well as for new structures. Lively investment is set to extend into 2007, albeit at a somewhat slower pace of 4 percent.

Goods exports, the principal driver of the upswing, are gaining 10 percent in volume in 2006. Part of the momentum is due to purchases carried forward in Germany ahead of the VAT increase at the beginning of 2007. The expected jump in car purchases in Germany will give a boost also to domestic suppliers to the German motor car industry. Correspondingly, 2007 will see a slump in demand and, more generally, global demand will slacken. Austrian exports will therefore post more moderate gains of less than 7 percent in volume.

Private consumption in Austria, while rising markedly faster (at 1.9 percent in volume) than on average during the last few years, is trailing other demand components. Growth in 2007, although edging up to 2.1 percent, will still be weaker than in earlier periods of cyclical upswing, since household disposable income will increase only moderately, despite gains in employment.

In the wake of the cyclical revival, the number of people in dependent active employment is rising substantially this year, by 46,000 or 1.5 percent. In manufacturing, the downward trend of the past years is coming to a halt, and the construction sector is adding importantly to its workforce. Employment creation is increasingly extending to full-time jobs. The number of registered unemployed is falling by 11,000 this year, to a total 242,000. This mirrors the rebound in economic activity, but also the efforts to enrol more people in job training. Although growth is set to abate, unemployment is expected to remain flat in 2007. The jobless rate, on national definitions, is receding to 6.9 percent of the dependent labour force this year and to 6.8 percent in 2007.

Table 1: Main results

		2002	2003	2004	2005	2006	2007
		Percentage changes from previous year					
GDP							
Volume		+ 0.9	+ 1.1	+ 2.4	+ 2.0	+ 3.1	+ 2.5
Value		+ 2.3	+ 2.4	+ 4.2	+ 3.9	+ 4.7	+ 4.2
Manufacturing ¹ , volume		+ 0.4	+ 0.1	+ 2.4	+ 2.4	+ 6.7	+ 5.0
Wholesale and retail trade, volume		+ 2.3	+ 0.5	+ 1.3	+ 0.3	+ 1.7	+ 2.1
Private consumption expenditure, volume		+ 0.1	+ 1.3	+ 1.9	+ 1.7	+ 1.9	+ 2.1
Gross fixed investment, volume		- 6.0	+ 5.9	+ 0.6	+ 0.3	+ 5.0	+ 4.0
Machinery and equipment ²		- 7.9	+ 6.8	- 0.7	+ 0.1	+ 7.0	+ 5.5
Construction		- 4.5	+ 5.1	+ 1.6	+ 0.4	+ 3.5	+ 2.7
Exports of goods ³							
Volume		+ 4.8	+ 2.6	+12.9	+ 2.2	+10.1	+ 6.8
Value		+ 4.2	+ 1.9	+13.9	+ 5.4	+12.9	+ 7.9
Imports of goods ³							
Volume		- 0.1	+ 6.5	+11.4	+ 2.3	+ 8.0	+ 7.0
Value		- 2.0	+ 5.0	+12.5	+ 5.9	+11.8	+ 8.3
Current balance	billion €	+ 0.75	- 0.48	+ 0.36	+ 3.01	+ 3.25	+ 3.18
As a percentage of GDP		+ 0.3	- 0.2	+ 0.2	+ 1.2	+ 1.3	+ 1.2
Long-term interest rate ⁴	in percent	5.0	4.2	4.2	3.4	3.8	4.2
Consumer prices		+ 1.8	+ 1.3	+ 2.1	+ 2.3	+ 1.6	+ 1.7
Unemployment rate							
Eurostat definition ⁵	in percent	4.2	4.3	4.8	5.2	5.0	5.0
National definition ⁶	in percent	6.9	7.0	7.1	7.3	6.9	6.8
Persons in active dependent employment ⁷		- 0.5	+ 0.2	+ 0.7	+ 1.0	+ 1.5	+ 1.2
General government financial balance according to Maastricht definition							
As a percentage of GDP		- 0.5	- 1.6	- 1.2	- 1.5	- 1.6	- 1.3

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, as a percentage of total labour force excluding self employed. – ⁷ Excluding parental leave, military service, and unemployed persons in training.

Despite the important price increases for energy and other commodities in the last few years, second-round inflationary effects are still largely absent. The below-average pace of growth so far and the subdued labour market situation have prevented a more noticeable pass-through of the oil price jump to the consumer price index. For 2006, WIFO expects an average inflation rate of 1.6 percent, edging up to 1.7 percent in 2007. Although improved business conditions in the euro area will add to inflation, the impact of higher energy prices is expected to ebb in 2007.

Because of some lags in the impact of the 2005 tax reform, the general government deficit is going up from 1.5 percent of GDP in 2005 to 1.6 percent this year. Only in 2007 will the rebound in domestic demand reduce the deficit to 1.3 percent of nominal GDP.

Global economic activity is exceptionally strong in 2006. For the third year running, growth of world GDP is close to 5 percent and has now reached all major economic zones. While the economies of the USA and Southeast Asia have for some time been expanding briskly, activity has picked up significantly this year also in Japan and the euro area. Although high raw materials prices dampen the pace of growth, they are mainly the result of the strong momentum of global activity, apart from a number of supply bottlenecks. On the basis of latest developments on oil markets, the average oil import price of the industrialised countries has been assumed at \$ 65 per barrel, compared with a level of \$ 68 retained in the projections of last June. By way of a

Slight deceleration of global growth in 2007

technical assumption, the level of \$ 65 per barrel has been held constant for 2007. Like three months ago, the new projections have been based upon an exchange rate of \$ 1.25 per euro.

The expected slowdown in the USA as a result of major macro-economic imbalances (deficits in the government budget and in the current account, massive increase in real estate prices accompanied by a negative private household saving ratio) is likely to start weighing on aggregate demand in 2006. Consumer spending in the USA is losing momentum, notably for purchases of durable goods. Residential investment, after a stagnation during the two previous quarters, slumped by a seasonally-adjusted annualised rate of over 10 percent between April and June, with building permits suggesting an even stronger fall for the months ahead. GDP growth is expected to slow from 3.3 percent in 2006 to 2.5 percent in 2007, dampening to some extent also world economic activity.

As a result, world trade will slacken. China's economic growth will slow down slightly on the back of weaker demand from the USA. The gradual decoupling of the renminbi from the dollar will hardly undermine China's competitiveness over the medium term. The Japanese economy should have resumed a sustained upward path. While growth in Japan will also slow down in 2007, a relapse into stagnation appears unlikely, since also the stubborn deflation seems finally to have been overcome.

At a projected 5.2 percent in 2006, the group of new EU member states will enjoy the highest rate of GDP growth in several years. In Hungary and the Czech Republic, internal demand is rising briskly, along with exports. Likewise, GDP in Poland, the largest economy in East-Central Europe is expanding strongly. Demand for Austrian goods is growing this year particularly in Hungary and Slovenia.

The slower cyclical momentum abroad will also dampen export growth in these countries in 2007. With GDP growth moderating to 5 percent, the positive gap vis-à-vis the euro area will nevertheless remain constant.

New member states benefit from upswing in the EU

Strong business activity in western Europe is providing growth incentives also for the new EU member states. In the latter, however, the acceleration of growth is less pronounced than in the euro area, such that the catching-up process is losing somewhat momentum this year.

Table 2: World economy

	2002	2003	2004	2005	2006	2007	
	Percentage changes from previous year						
<i>Real GDP</i>							
World total	+ 3.1	+ 4.1	+ 5.3	+ 4.9	+ 5.0	+ 4.5	
Total OECD	+ 1.6	+ 2.0	+ 3.2	+ 2.6	+ 3.0	+ 2.5	
USA	+ 1.6	+ 2.5	+ 3.9	+ 3.2	+ 3.3	+ 2.5	
Japan	+ 0.1	+ 1.8	+ 2.3	+ 2.6	+ 2.8	+ 2.5	
EU 25	+ 1.2	+ 1.3	+ 2.4	+ 1.6	+ 2.7	+ 2.4	
EU 15	+ 1.1	+ 1.1	+ 2.2	+ 1.5	+ 2.6	+ 2.3	
Euro area	+ 0.9	+ 0.8	+ 1.9	+ 1.4	+ 2.6	+ 2.3	
Germany	± 0.0	- 0.2	+ 1.2	+ 0.9	+ 2.4	+ 1.7	
New member states ¹	+ 2.5	+ 3.8	+ 5.1	+ 4.4	+ 5.2	+ 5.0	
China	+ 9.1	+10.0	+10.1	+10.2	+10.0	+ 9.5	
<i>World trade, volume</i>	+ 3.5	+ 5.0	+10.0	+ 7.1	+ 8.5	+ 7.5	
<i>Market growth²</i>	+ 2.0	+ 5.6	+ 9.1	+ 6.8	+ 9.0	+ 6.0	
<i>Primary commodity prices</i>							
HWWA index, total	- 5	- 4	+18	+29	+27	+ 0	
Excluding energy	- 6	- 6	+18	+ 6	+22	+ 1	
<i>Crude oil prices</i>							
Average import price (cif) for OECD countries	\$ per barrel	24.1	28.4	36.3	50.3	65.0	65.0
<i>Exchange rate</i>							
\$ per euro	0.945	1.131	1.243	1.245	1.25	1.25	

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

Growth in the euro area, having picked up significantly already in early 2006, gained further momentum in the second quarter. Real GDP edged up by a seasonally-adjusted 0.9 percent from the previous period, more strongly than in the USA (+0.6 percent). While early in the year, exports were the driving force, their pace slowed somewhat in the second quarter, from +3.9 percent in volume quarter-on-quarter to +1.3 percent. At the same time, investment demand strengthened from +0.9 percent to +2.1 percent.

Private consumption also picked up in the first quarter, by an inflation-adjusted 0.7 percent, although the momentum abated to +0.3 percent in the following three-months period. Surveys of consumer confidence in the euro area show a steady upward trend, even if the indicator remains well below its level of the past years.

In the current year, consumption of private households in the euro area is contributing only to a small extent to the cyclical upswing. However, with disposable income rising on the back of an improving labour market and the saving ratio declining as a result of stronger consumer sentiment, consumption should lend firm support to business activity in 2007, despite the effect of the VAT increase in Germany. Together with investment, the revival of consumption should partly offset the external demand slowdown originating from the US economy.

The WIFO projection for the euro area is for GDP growth of 2.6 percent in 2006, an upward revision by ½ percentage point. Higher private consumption will strengthen internal demand in 2007, but the negative echo effect from the advance purchases ahead of the VAT increase in Germany, together with the slowdown of the international business cycle will dampen overall growth to a rate of 2.3 percent.

Money supply growth in the euro area abated in June for the first time this year, to an annual rate of 8.5 percent. At the same time, credit expanded strongly, leading to a liquidity overhang. Since producer prices in the euro area continue to exert upward pressure on expected inflation and the cyclical outlook has markedly improved, the projections assume that the ECB will raise interest rates further, to 3.5 percent by the end of the year for the key rate, remaining constant at that level throughout 2007.

Having stagnated during the last few years, activity in Germany picked up significantly in early 2006. For the year as a whole, growth is projected at 2.4 percent in volume terms. At the beginning of the year, the rebound was largely led by exports, with private consumption also heading up. Later on, a jump in gross fixed capital formation (by an inflation-adjusted 3.5 percent in the second quarter from the previous period) took over as pacesetter, while net exports and private consumption slackened. For the first time in more than a decade, the downward trend in construction came to a halt, confirming the broadening base of the upswing.

As from the beginning of 2007, the VAT rate will be raised by 3 percentage points to 19 percent. This should induce many households to carry forward major purchases into the current year. Private consumption will therefore increase more strongly this year than what would be expected in the present stage of the cycle. This is confirmed by responses from German consumer confidence surveys on purchases planned. A corresponding negative echo effect is likely to show up in 2007. Yet, the present projections assume that the underlying positive trend will extend into next year and that GDP in Germany will increase by an annual average 1.7 percent.

According to the latest business survey from the ifo institute, the cyclical situation remained excellent until September. The indicator for current business conditions reached its highest level in 12 years already last March and has further gained strongly since. However, in the last few months, firms have turned more cautious with regard to the short-term outlook, apparently anticipating the "echo effect" following the advance purchases as well as a deceleration of activity from the boom of the last few months.

Investment demand in the euro area as the key cyclical determinant

The impulse from the pick-up in euro area exports in 2005 is being transmitted to investment in the current year. In 2007, the rebound in private consumption will partly offset the slackening of foreign demand.

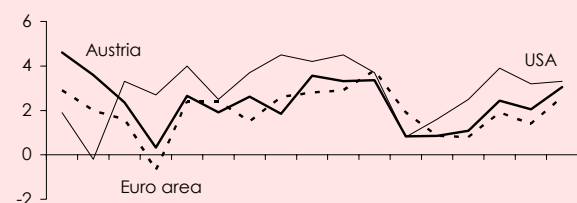
Broad-based growth of the German economy

In Germany, all components of aggregate demand are heading up this year. Private consumption is boosted further by advance purchases ahead of the value added tax increase.

Figure 1: Indicators of economic performance

Growth of real GDP

Percent



Employment and unemployment

1,000 from previous year



Manufacturing and investment

Percentage changes from previous year, volume



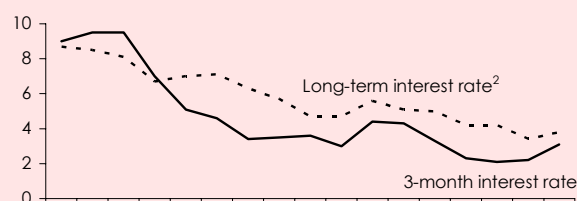
Consumption and income

Percentage changes from previous year, volume



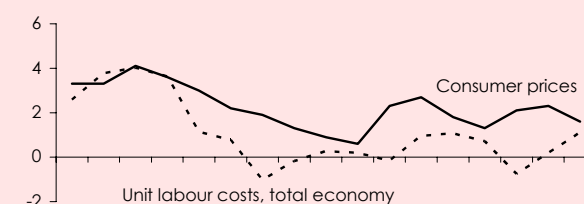
Short-term and long-term interest rates

Percent



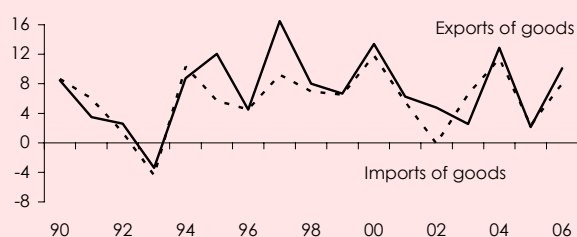
Inflation and unit labour costs

Percentage changes from previous year



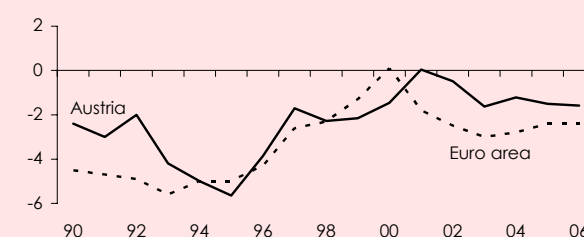
Trade

Percentage changes from previous year, volume



General government financial balance

As a percentage of GDP



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

The cyclical upturn which was set in motion towards the end of 2005 is continuing in the current year. Following a slowdown at the beginning of the year, growth regained considerable momentum in the second quarter. GDP is expected to expand by 3.1 percent on annual average, a pace last recorded in 2000. Growth is projected to decelerate in 2007, on the back of slackening global activity and a pause in demand for motor cars in Germany. While thus the external impulse will weaken, domestic demand should rather gain strength. Investment will likely see another solid increase, and consumer spending should shift into higher gear. In all, GDP is projected to rise by 2.5 percent.

In Austria, strongest growth in six years

Results from the latest WIFO business survey confirm the favourable domestic situation. The industrial confidence indicator calculated on the basis of these results regained in August its high level of the year 2000, with notably the volume of foreign orders being rated highly satisfactory. The latter holds in particular for the cyclically-sensitive branches of primary and intermediate goods, motor cars and investment goods, but also for manufacturers of durable consumer goods. Output expectations for the next few months also improved significantly, pointing to continued solid growth in the near term. Producers of cars and vehicle components are particularly optimistic, since they stand to largely benefit in the second half of 2006 from the advance purchases in view of the VAT increase in Germany.

In contrast to Germany, expectations for the medium term remain on a high level for almost all sectors except for producers of non-durable consumer goods.

In 2006, Austrian exports are performing remarkably well. Since the onset of the year, deliveries to Germany and Italy, to central and eastern Europe (Hungary, Slovenia), but also to Russia and Ukraine have posted strong gains. Lively intra-EU demand is a key factor, but exports to the OPEC countries also expanded significantly, thereby partially offsetting the drag in purchasing power from the high oil prices. Exports to the EU accession candidates of Bulgaria and Romania also jumped markedly.

In the first half of 2006, foreign demand for chemicals and manufactured goods rose strongly. The key sector of machines and motor vehicles also enjoyed lively momentum that is set to further accelerate in the second semester. For the whole year, merchandise exports can be expected to increase by 10 percent in volume. Despite some moderation in 2007, exports will remain buoyant, with a projected 6¾ percent increase, thanks to the resilience of activity in the euro area and gains in market shares. Austria's relative unit labour cost position in manufacturing will further improve, with the real-effective exchange rate index for industrial goods declining steadily over the forecast period. The imminent accession of Bulgaria and Romania to the EU will provide additional stimulus.

Demand and output in Austria are set to expand by 3.1 percent this year, a strength not seen for a long time. Growth is likely to abate to 2.5 percent in 2007, although domestic demand should remain firm.

Exports as the driver of growth in the first half of 2006

Strong business activity worldwide and improved competitiveness are fuelling domestic exports this year. In 2007, foreign trade will no longer be the key driver of growth.

Table 3: Earnings and international competitiveness

	2002	2003	2004	2005	2006	2007
	Percentage changes from previous year					
Gross earnings per employee ¹	+ 2.2	+ 1.9	+ 1.9	+ 1.7	+ 2.8	+ 2.5
Gross real earnings per employee ¹	+ 1.0	+ 0.3	- 0.0	+ 0.0	+ 1.2	+ 0.8
Net real earnings per employee ¹	+ 0.7	+ 0.0	+ 0.1	+ 1.1	+ 0.6	+ 0.3
Total economy						
Unit labour costs	+ 1.1	+ 0.7	- 0.8	+ 0.2	+ 1.1	+ 0.8
Manufacturing						
Unit labour costs	- 0.6	+ 0.8	- 0.8	- 0.7	- 3.3	- 2.3
Relative unit labour costs ²						
Vis-à-vis trading partners	- 1.1	+ 3.6	+ 2.1	+ 0.1	- 2.3	- 1.6
Vis-à-vis Germany	- 1.9	+ 2.4	+ 3.2	+ 2.9	- 0.8	- 0.3
Effective exchange rate, manufactures						
Nominal	+ 1.2	+ 3.7	+ 1.2	- 0.5	+ 0.2	± 0.0
Real	+ 0.8	+ 2.9	+ 1.0	- 0.5	- 0.6	- 1.0

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

Because of the close link between foreign trade and domestic capital formation, the revival of investment this year will also lead to a pick-up in imports in the national accounts definition. The projection is for an increase by 8 percent in volume, after slightly less than +6 percent in 2005. Stronger consumer demand should keep imports growing at a solid 7 percent rate in 2007.

During the last years, economic activity in Austria was marked by conspicuously sluggish capital formation. Following a decline in machinery and equipment investment by 1.6 percent in real terms in 2004 and virtual stagnation (+0.2 percent) in 2005, a significant pick-up of this key demand component has become visible this year. Already the first three months saw an increase by a seasonally-adjusted 2.1 percent in volume from the previous period, which accelerated to 3 percent in the second quarter. Demand is concentrated on machinery and electronic equipment, but also on motor vehicles. Results from the regular WIFO business survey confirm the rising investment propensity in manufacturing industry. For the whole year, a gain of 7 percent in volume can be expected for investment in machinery and equipment (including "other items" of capital formation). The favourable investment climate will extend into 2007, with an expected further gain of 5½ percent.

Investment in construction also remained below its long-term average in 2004 and 2005, with volume growth rates of 1.6 percent and 0.4 percent, respectively. As from the first quarter 2006, activity picked up, although the results, being heavily influenced by seasonal conditions, are difficult to interpret. The stronger momentum was maintained in the second quarter, when firms reported a marked increase in both construction output and employment. The order situation bodes well for continued lively activity, with residential construction eventually also benefiting after a long period of sluggishness. WIFO now expects construction investment to expand by 3½ percent in 2006, moderating to 2¾ percent in 2007.

Following an increase by an inflation-adjusted 1.7 percent in 2005, consumption by private households is likely to accelerate to 1.9 percent in the current year. Real growth in the first and second quarter amounted to only 0.5 percent each (from the previous period), with particularly the demand for motor cars being lacklustre. In the further course of the year, growth should gain momentum. While the rise in employment implies higher private disposable income, the saving ratio is assumed to go up in accordance with the usual cyclical pattern. Moreover, the increase in net wages and salaries will noticeably fall short of the trend in gross earnings.

Private consumption usually reacts only with a lag to a cyclical rebound of activity, but the projected increase by 2.1 percent in 2007 will still be moderate. In line with the typical cyclical pattern, demand for durable consumer goods should post above-average gains.

Investment lending major support to business activity

While growth at the beginning of the year was driven by exports, demand for capital goods strengthened markedly in the second quarter and is likely to provide major cyclical stimulus in the course of the year.

Consumption growth accelerating only slightly

Against the background of only moderate gains in private household disposable income and a rising saving ratio, consumption growth remains subdued in 2006. In 2007, it is set to rise above the average of the last few years, while still lagging behind its normal profile during a cyclical upswing

Table 4: Private consumption, income and prices

	2002	2003	2004	2005	2006	2007
	Percentage changes from previous year, volume					
Private consumption expenditure	+ 0.1	+ 1.3	+ 1.9	+ 1.7	+ 1.9	+ 2.1
Durables	+ 2.8	+ 3.1	+ 5.1	+ 2.2	+ 2.1	+ 2.5
Non-durables and services	- 0.3	+ 1.1	+ 1.5	+ 1.6	+ 1.9	+ 2.1
Household disposable income	+ 0.3	+ 2.1	+ 2.0	+ 2.1	+ 2.3	+ 2.1
	As a percentage of disposable income					
Household saving ratio	7.6	8.6	8.8	9.1	9.5	9.4
	Percentage changes from previous year					
Direct lending to domestic non-banks ¹	+ 1.2	+ 1.6	+ 5.0	+ 4.7	+ 5.8	+ 4.5
	Percentage changes from previous year					
Inflation rate						
National	1.8	1.3	2.1	2.3	1.6	1.7
Harmonised	1.7	1.3	2.0	2.1	1.9	1.9
Core inflation ²	2.0	1.3	1.6	1.5	1.3	1.8

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

Inflation in Austria, as measured by the national consumer price index, rose to 1.8 percent year-on-year in August, up from an average 1.5 percent in the first six months. For the whole year, the projection is for an average rate of 1.6 percent. Unlike in previous episodes, the energy price hike of the last few years has so far not led to a general acceleration of inflation. Prices of manufactures remain broadly stable, and the increase in per-capita wages in manufacturing, at +3.4 percent in the first half of 2006, is well below the gains in productivity.

Energy price hike without second-round effects

Table 5: Productivity

	2002	2003	2004	2005	2006	2007
	Percentage changes from previous year					
<i>Total economy</i>						
Real GDP	+ 0.9	+ 1.1	+ 2.4	+ 2.0	+ 3.1	+ 2.5
Employment ¹	- 0.1	- 0.1	- 0.0	+ 0.5	+ 1.0	+ 0.8
Productivity (GDP per employment)	+ 1.0	+ 1.1	+ 2.5	+ 1.6	+ 2.0	+ 1.7
<i>Manufacturing</i>						
Production ²	+ 0.4	+ 0.1	+ 2.3	+ 2.6	+ 6.7	+ 5.0
Employees ³	- 2.5	- 1.7	- 0.6	- 0.9	± 0.0	- 0.2
Productivity per hour	+ 3.5	+ 1.4	+ 2.0	+ 4.1	+ 6.1	+ 5.2
Working hours per day per employee ⁴	- 0.5	+ 0.3	+ 0.8	- 0.6	+ 0.6	± 0.0

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.

On the assumption of henceforth unchanged oil prices (both on a euro and a dollar basis), inflation will remain moderate also in 2007, at a rate of 1.7 percent, even in the face of better cyclical conditions. The projected increase in core inflation (according to the HICP) from 1.3 percent in 2006 to 1.8 percent in 2007, though reflecting the cyclical component, will be kept in check by the persisting comfortable margin of spare capacity as a result of abundant labour supply as well as strong investment growth.

As predicted last June, the massive increase in commodity prices has so far not led to higher wage claims. Also in 2007, inflation will hardly accelerate, in spite of the improved cyclical conditions.

Table 6: Labour market

	2002	2003	2004	2005	2006	2007	
	Changes from previous year, in 1,000						
<i>Demand for labour</i>							
Persons in active employment ¹	- 11.6	+ 8.5	+ 25.1	+ 37.2	+ 51.5	+ 43.5	
Employees ²	- 15.0	+ 5.5	+ 21.1	+ 31.9	+ 46.0	+ 38.0	
Percentage changes from previous year	- 0.5	+ 0.2	+ 0.7	+ 1.0	+ 1.5	+ 1.2	
Nationals	- 20.1	- 10.4	+ 9.2	+ 20.0	+ 30.0	+ 24.0	
Foreign workers	+ 5.1	+ 15.9	+ 11.9	+ 11.9	+ 16.0	+ 14.0	
Self-employed ³	+ 3.4	+ 3.0	+ 4.0	+ 5.3	+ 5.5	+ 5.5	
<i>Labour supply</i>							
Population of working age	15 to 64 years	+ 42.9	+ 37.7	+ 34.4	+ 15.6	+ 6.1	+ 20.2
	15 to 59 years	+ 13.4	+ 21.2	+ 35.6	+ 48.5	+ 37.7	+ 24.9
Labour force ⁴		+ 17.0	+ 16.1	+ 28.9	+ 45.9	+ 40.5	+ 43.5
<i>Surplus of labour</i>							
Registered unemployed ⁵		+ 28.5	+ 7.7	+ 3.8	+ 8.8	- 11.0	± 0.0
In 1,000		232.4	240.1	243.9	252.7	241.7	241.7
Percent							
<i>Unemployment rate</i>							
Eurostat definition ⁶		4.2	4.3	4.8	5.2	5.0	5.0
As a percentage of total labour force ⁵		6.2	6.3	6.4	6.5	6.2	6.1
National definition ^{5,7}		6.9	7.0	7.1	7.3	6.9	6.8
<i>Employment rate</i>							
Persons in active employment ^{1,8}		62.5	62.2	62.3	62.8	63.6	64.2
Total employment ^{6,8,9}		-	-	67.8	68.6	68.9	69.2

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 Labour Market Service. – 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.

The Harmonised Index of Consumer Prices (HICP) will rise by 1.9 percent each in 2006 and 2007, keeping Austria among the euro area countries with the highest degree of price stability.

WIFO expects the number of people in dependent active employment to increase by 1.5 percent in 2006, the strongest gain since 1991. Full-time jobs are being created to a rising extent, confirming the cyclical stimulus to labour demand. At the same time, the number of registered unemployed is falling by 11,000 – partly reflecting higher enrolment in training activities, but increasingly also the genuine job increase. The rate of unemployment, on national definitions, is abating from 7.3 percent in 2005 to 6.9 percent, the harmonised Eurostat rate is projected at 5 percent of the total labour force.

With GDP growth decelerating somewhat in 2007, labour demand will rise less strongly than this year. WIFO expects the number of people in dependent active employment to grow by 1.2 percent in 2007. Since the increase in real GDP of 2.5 percent will correspond to the threshold for a decline in unemployment, the jobless figure will remain unchanged at around 242,000. Still, the rise in employment will allow the unemployment rate to edge down in 2007 to 6.8 percent of the dependent labour force.

After a general government deficit corresponding to 1.5 percent of nominal GDP in 2005, the negative balance is set to widen slightly this year, to a ratio of 1.6 percent. Government expenditure will increase on account of higher outlays for active labour market policy and research. The adjustment of pensions for inflation and a wage increase for government employees also exert upward pressure on expenditure. Although the cyclical revival will also boost revenues, this is partly offset by lagged revenue shortfalls from the 2005 tax reform.

Employment rising strongly, unemployment in slight decline

A marked increase in employment in 2006 will be accompanied by a fall in unemployment. GDP growth is nowadays giving rise to the creation also of full-time jobs. Apart from the improved cyclical situation, unemployment is reduced by more job training facilities being offered by the labour market service.

Discretionary measures keeping government deficit broadly unchanged in 2006

The general government balance for 2006 is influenced by last year's tax reform and some discretionary increase in expenditure. Only in 2007 will stronger domestic business activity lead to a substantial reduction in the deficit.

Table 7: Key policy indicators

	2002	2003	2004	2005	2006	2007
	As a percentage of GDP					
<i>Fiscal policy</i>						
General government financial balance						
According to Maastricht definition	-0.5	-1.6	-1.2	-1.5	-1.6	-1.3
According to National Accounts	-0.7	-1.7	-1.3	-1.6	-1.7	-1.4
General government primary balance	+2.6	+1.3	+1.6	+1.3	+1.2	+1.4
	Percent					
<i>Monetary policy</i>						
3-month interest rate	3.3	2.3	2.1	2.2	3.1	3.8
Long-term interest rate ¹	5.0	4.2	4.2	3.4	3.8	4.2
	Percentage changes from previous year					
<i>Effective exchange rate</i>						
Nominal	+1.3	+3.8	+1.2	-0.6	+0.2	±0.0
Real	+0.6	+2.8	+0.9	-0.7	-0.7	-1.0

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

Since GDP growth this year is mainly driven by exports and investment, the benign cyclical impact on the budget deficit remains small. When in 2007 the upswing will receive increased support from private consumption, revenues from consumption taxes will grow more strongly. Given that following the recent general elections a new government still needs to be formed, the evolution of government spending next year is difficult to assess at this stage. The projection of a deficit of 1.3 percent of GDP for 2007 is therefore subject to considerable uncertainty. Underlying this figure is notably the assumption that stage II of the administrative reform will be implemented at all levels of government and some restraint will be exerted on expenditure for active labour market policy. Moreover, in 2007 the "SME package" will take effect, providing measures of support for small and medium-sized enterprises. The reinforcement of tax concessions for undistributed profits of unincorporated enterprises will lead to revenue shortfalls of an estimated € 200 million in coming years.