Josef Baumgartner, Serguei Kaniovski, Hans Pitlik, Margit Schratzenstaller, Thomas Url

Exports Drive Growth – Domestic Demand Remains Subdued

Medium-term Projections for the Austrian Economy until 2015

Supported by strong and dynamic export growth the Austrian economy will expand by 2.2 percent per year in real terms during the period from 2011 until 2015. Due to measures to consolidate public finances and the cyclical improvement a reduction of the deficit ratio below 2 percent of GDP by 2015 seems within reach. To achieve a sustainable slowdown of expenditure growth, however, fundamental structural reforms are necessary. Employment will increase by 0.6 percent in the years from 2011 to 2015. As the foreign and domestic labour supply will expand at roughly the same pace, labour market conditions are not expected to ease further until 2014. On average 6.8 percent of the dependent labour force will be out of work. In the coming years, crude oil and other commodity prices will continue to rise. The increase in indirect taxes in the course of the budget consolidation will raise the inflation rate by 0.4 percentage points to 2.1 percent in 2011. During the forecast period the average annual rate of inflation will be 1.9 percent.

The authors are thankful to Karl Aiginger and Markus Marterbauer for useful and constructive comments. The data were processed and analysed with the assistance of Christine Kaufmann • **E-Mail addresses: Josef.Baumgartner@wifo.ac.at, Serguei.Kaniovski@wifo.ac.at, Hans.Pitlik@wifo.ac.at, Margit.Schratzenstaller@wifo.ac.at, Thomas.Url@wifo.ac.at**

In mid-2008, the international financial and economic crisis triggered a severe recession in Austria. Real GDP contracted by 3.9 percent in 2009. Supported by strong and dynamic export growth, not least a result of expansionary monetary and fiscal policies in major economic regions and a rapid recovery in emerging economies (particularly in BRIC countries), the tide turned in mid-2009. In 2010, the Austrian economy expanded by 2 percent and for the period 2011-2015 annual real growth is projected at 2.2 percent. This means that the growth rate of the Austrian economy is expected to lag behind that seen in the ten years prior to the crisis by about ¼ percentage point[1]. The growth rate of trend output will slow down, too[2]. Between 2011 and 2015, it will remain about ½ percentage point below the rate of the 10 years before the crisis at 1.7 percent per year (*Gaggl – Janger,* 2009, *European Commission,* 2009A, *IMF,* 2009).

The global economy – and in particular the major emerging economies in Asia and Latin America – has overcome the aftermath of the crisis faster than anticipated and expanded by 4½ percent in real terms in 2010. On average this growth rate is expected to persist during 2011-2015. The revival of world trade causes Austrian exports to increase by an average of 6.2 percent per year, which is close to the rates seen in the ten years before the crisis. As import growth is slightly slower at 5.8 percent on average, hence net exports are delivering a positive contribution to GDP growth.

---

[1] The growth forecast for 2010 to 2012 is based on WIFO's short term forecast of December 2010. For subsequent years medium-term trends have been estimated.

[2] Trend output (potential output) describes a concept of potential economic growth determined by the supply side, where production factors capital, labour and technology available in the medium term, are utilised at normal capacity (*Steindl,* 2006).

The rebound in export activity could not spur investment sufficiently in 2010 (–3.1 percent), because capacity utilisation was still very low at the beginning of the year. During the forecast period 2011-2015 investment is expected to increase, too, owing to a persistently high export demand (gross fixed capital formation: +2.9 percent per year).

The measures to counter the recession, which came into effect in 2009 and 2010 (tax reform, increase of government transfers, short time working schemes), propped up real disposable income of households and stabilised the macroeconomic via an increase in private consumption. The latter is expected to grow by an average of 1.2 percent per year during 2011-2015.

Table 1: Main results

	Ø 2000-2005	Ø 2005-2010	Ø 2010-2015	2010	2011	2012	2013	2014	2015
					Year-to-year percentage changes				
Gross domestic product									
Volume	+ 1.6	+ 1.5	+ 2.2	+ 2.0	+ 2.2	+ 2.0	+ 2.1	+ 2.2	+ 2.2
Value	+ 3.3	+ 3.1	+ 3.9	+ 3.2	+ 3.8	+ 3.8	+ 3.8	+ 4.0	+ 4.0
Consumer prices	+ 2.0	+ 1.8	+ 1.9	+ 1.8	+ 2.1	+ 1.8	+ 1.8	+ 1.9	+ 2.0
Gross wages and salaries per employee[1]	+ 1.9	+ 2.4	+ 2.5	+ 1.4	+ 2.0	+ 2.3	+ 2.5	+ 2.7	+ 2.9
Persons in active dependent employment[2]	+ 0.4	+ 1.1	+ 0.6	+ 1.0	+ 0.6	+ 0.5	+ 0.6	+ 0.7	+ 0.7
	Ø 2001-2005	Ø 2006-2010	Ø 2011-2015	2010	2011	2012	2013	2014	2015
					In percent				
Unemployment rate									
Eurostat definition[3]	4.4	4.5	4.4	4.5	4.4	4.5	4.5	4.4	4.3
National definition[4]	6.9	6.6	6.8	6.9	6.8	6.9	6.9	6.8	6.7
					As a percentage of GDP				
Net exports	3.7	5.3	6.4	5.4	5.9	6.4	6.6	6.7	6.7
General government financial balance (Maastricht definition)	– 1.6	– 2.0	– 2.4	– 4.1	– 3.1	– 2.7	– 2.4	– 2.1	– 1.8
					As a percentage of disposable income				
Household saving ratio	8.8	11.1	10.3	10.6	10.2	10.0	10.1	10.3	10.7
	Ø 2000-2005	Ø 2005-2010	Ø 2010-2015	2010	2011	2012	2013	2014	2015
					Year-to-year percentage changes				
Potential output, volume	+ 2.2	+ 1.9	+ 1.7	+ 1.7	+ 1.7	+ 1.6	+ 1.6	+ 1.6	+ 1.7
	Ø 2001-2005	Ø 2006-2010	Ø 2011-2015	2010	2011	2012	2013	2014	2015
					As a percentage of Potential output				
Output gap, volume	– 0.9	– 0.3	– 1.8	– 3.1	– 2.7	– 2.3	– 1.8	– 1.3	– 0.8

Source: Statistics Austria, WIFO calculations. – [1] Excluding employers' contributions, employees according to National Accounts definition. – [2] Excluding parental leave, military service, and unemployed persons in training. – [3] According to Eurostat Labour Force Survey, percent of total labour force. – [4] According to Public Employment Service Austria, percent of total labour force excluding self-employed.

The two stimulus packages and the tax reform of 2009 as well as other economic policy measures to mitigate the crisis, the cyclical decline in tax revenues and the cyclical increase in government spending caused the budget deficit to rise to 3.5 percent and 4.1 percent of GDP in 2009 and 2010, respectively. Due to the envisaged consolidation measures of the federal government and the pick-up in economic activity a reduction of the deficit ratio to below 2 percent of GDP by 2015 seems within reach. However, for a sustainable cutback of expenditure growth fundamental structural reforms are required in the fields of health, public administration and the organisation of the state as well as subsidies.

Despite countervailing labour market policies (such as short-time working schemes, training and educational leave) the number of employees declined by 1.4 percent during the economic crisis of 2009, the number of unemployed persons (annual average in 2009: 260,000) reached the highest level since the mid-1950s and the unemployment rate amounted to 7.2 percent of the dependent labour force (according to the Public Employment Service Austria, AMS). The pick-up in economic activity in 2010 brought about an expansion of the number of employees by 1 percent and a decline of the unemployment rate by 0.3 percentage points. The number of employees will increase by 0.6 percent per year in 2011 to 2015. As the domestic and the foreign labour supply will grow at roughly the same pace during this period, labour market conditions are not expected to ease further until 2014. On average the unemployment rate is likely to stay at 6.8 percent of the dependent labour force. To reduce unemployment to the pre-crisis level (5.8 percent) additional measures of active labour market policy are required.

After the deterioration of prices from mid-2008 to the first quarter of 2009 the rising trend in international commodity markets bounced back. It is expected that over the coming years prices of crude oil and other commodities will surge further. The forecast assumes that crude oil price will rise from $ 79 per barrel in 2010 to $ 105 in 2015 as the world economy recovers. The rise in indirect taxes in the course of the budget consolidation will increase the inflation rate by 0.4 percentage points to 2.1 percent in 2011. From other domestic sources hardly any inflationary effects are expected. Over the period 2011-2015 the average rate of inflation is likely to reach 1.9 percent.

The recovery of the Austrian economy assumed in this forecast essentially hinges on the improvement in international economic activity. If the later does not materialise to the expected extent – e.g., due to a worsening of the sovereign debt crisis in the EU –, this would also impair the economic revival in Austria. Financial market conditions as well as the situation of the banking system remain fragile, too.

A positive growth differential vis-à-vis the euro area will persist

From 2004 to 2008 real GDP expanded much faster in Austria than in the euro area average (+¾ percentage points). The decline in the recession in 2009 also turned out much weaker in Austria (–0.2 percentage points), and in 2010 the pace of the recovery in the Austrian economy exceeded that of the euro area by 0.3 percentage points. Over the forecast period 2011-2015 a positive growth differential of ¼ percentage point is likely to persist:

- Due to the sovereign debt crisis in some euro area countries[3] substantial consolidation measures have already been adopted or prepared. In Austria, the need for consolidation is significantly lower entailing weaker dampening effects on demand.
- The economies of the new EU countries in Central and Eastern Europe as well as in Southern Europe are likely to show again stronger growth in the coming years (*Schulmeister,* 2011, in this issue). Austrian companies are very well positioned in these markets (*FIW,* 2010) and will benefit from the recovery in this economic region.
- Based on unit labour costs Austria's international competitiveness has improved during the last ten years (*Guger – Leoni,* 2007, *Hölzl – Leoni – Zulehner,* 2009). This trend is likely to persist and positively affect on the export industry in the medium term (*European Commission,* 2010, Tables 28, 31).
- Unlike in a number of other euro area countries the crisis was not exacerbated by the bursting of a real estate bubble. The more favourable financial situation of Austria's private households supports their consumption demand (*Walterskirchen,* 2009).
- The increase of expenditures on research and development in recent years is expected to have a positive effect on the Austrian economy in the medium term.

[3] Greece and Ireland are currently affected; for Portugal, Spain and Italy the spreads of long-term bond yields over German Bunds as well as the current levels of the budget deficits and government debt (each as a percentage of GDP) point to a potential risk (*European Commission,* 2010, Tables 34, 37, 42).

Until 2012, this medium-term forecast for the Austrian economy is based on the WIFO's short-term forecast of December 2010 (*Ederer,* 2011, in this issue). The medium-term projections have been produced with the WIFO's macroeconometric model (*Baumgartner – Breuss – Kaniovski,* 2005) and are based on the global economic scenario outlined in detail in *Schulmeister* (2011, in this issue). Hence, only a brief sketch of the most important international developments affecting the forecast of the Austrian economy is provided here.

In the medium term exports spur growth, domestic demand remains subdued

The pick-up of world trade causes Austrian exports to increase by an average of 6.2 percent per year. As a consequence the domestic economy will expand by 2.2 percent per year. During the forecast period the growth rate of trend output will not exceed 1.7 percent. The output gap will thus decrease from –3.1 percent in 2010 to –0.8 percent by the end of the forecast period.

In 2011 and 2012, global economic activity will gain momentum again and the recession will be overcome. During the whole forecast period from 2011 to 2015 growth in the USA and in the euro area will reach 2.7 percent and 1.9 percent per year, respectively. In the new EU countries the average GDP increase is likely to amount to 3.7 percent per year during the coming five years. Due to the strong momentum in the large emerging economies (China, India, Brazil) the world economy will expand by 4.5 percent per year. Crude oil prices will surge from $ 79 per barrel in 2010 to $ 105 per barrel in 2015. The prices of other commodities will increase by an annual average of 3.7 percent. Further, the euro-dollar exchange rate is expected to depreciate from $ 1.33 per euro in 2010 to $ 1.2 per euro in 2012 and then to appreciate again to $ 1.35 per euro until 2015 (for further details *Schulmeister,* 2011, in this issue).

Table 2: International fundamentals

	Ø 2000-2005	Ø 2005-2010	Ø 2010-2015
	Year-to-year percentage changes		
Gross domestic product, volume			
Euro area	+ 1.5	+ 0.8	+ 1.9
23 OECD countries[1]	+ 2.0	+ 0.8	+ 2.5
	Ø 2001-2005	Ø 2006-2010	Ø 2011-2015
	Dollar per ECU or Euro		
Exchange rate	1.09	1.36	1.27
	Dollar per barrel		
Oil price			
Brent	34.2	75.1	98.2

Source: EU, OECD, WIFO calculations. – [1] EU 15 (excluding Austria), Island, Norway, Switzerland, Turkey, Australia, Japan, Canada, New Zealand, USA.

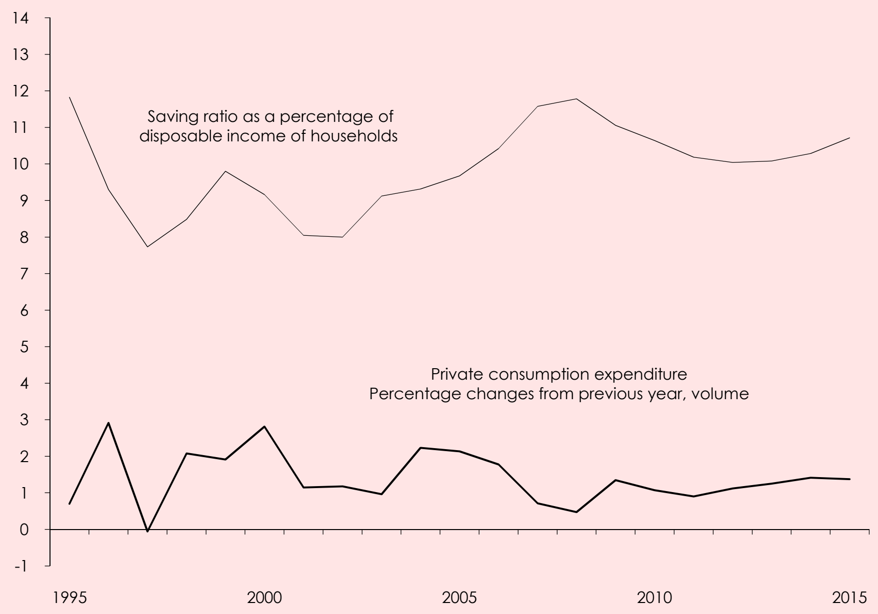
In the wake of the global financial and economic crisis Austria entered the worst recession since the 1930s. Owing to Austria's deep international integration also the recovery of its business activities will be driven by international developments. Real exports are expected to grow by 6.2 percent per year in 2011-2015. As real imports expand slightly less dynamically at 5.8 percent per year, the Austrian economy will continue to benefit from positive net exports.

Table 3: Components of aggregate demand, volume

	Ø 2000-2005	Ø 2005-2010	Ø 2010-2015	2010	2011	2012	2013	2014	2015
	Year-to-year percentage changes								
Consumption expenditure									
Private households[1]	+ 1.5	+ 1.1	+ 1.2	+ 1.1	+ 0.9	+ 1.1	+ 1.3	+ 1.4	+ 1.4
General government	+ 0.8	+ 1.9	+ 0.9	+ 0.5	– 0.2	± 0.0	+ 1.5	+ 1.6	+ 1.4
Gross fixed capital formation	+ 0.0	– 0.5	+ 2.9	– 3.1	+ 2.5	+ 2.3	+ 2.7	+ 3.3	+ 3.7
Machinery and equipment	+ 0.1	– 0.5	+ 4.8	– 2.0	+ 4.5	+ 4.0	+ 4.6	+ 5.3	+ 5.4
Construction	– 0.7	– 1.3	+ 1.2	– 4.0	+ 0.7	+ 0.8	+ 0.9	+ 1.4	+ 2.2
Domestic demand	+ 1.2	+ 0.9	+ 1.6	+ 0.8	+ 1.3	+ 1.3	+ 1.6	+ 2.0	+ 2.0
Exports	+ 5.8	+ 1.7	+ 6.2	+ 9.7	+ 7.0	+ 6.4	+ 6.1	+ 5.9	+ 5.9
Imports	+ 5.1	+ 0.6	+ 5.8	+ 8.0	+ 5.7	+ 5.7	+ 5.8	+ 5.9	+ 5.9
Gross domestic product	+ 1.6	+ 1.5	+ 2.2	+ 2.0	+ 2.2	+ 2.0	+ 2.1	+ 2.2	+ 2.2

Source: Statistics Austria, WIFO calculations. – [1] Including private non-profit institutions serving housholds.

Figure 1: Private consumption and saving ratio



Source: Statistics Austria, WIFO calculation.

Figure 2: Output gap

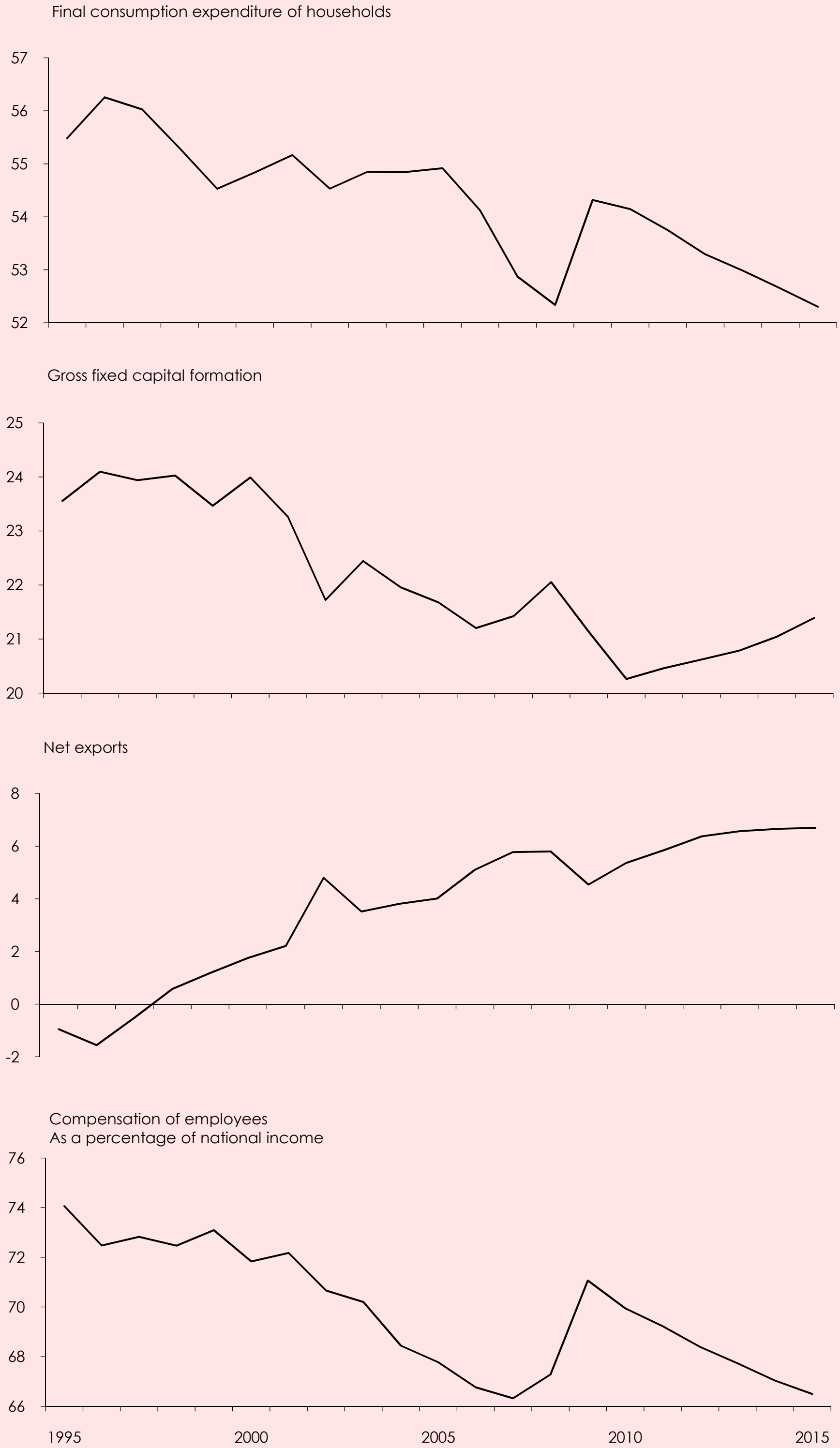
As a percentage of potential output

Source: Statistics Austria, WIFO calculation.

In 2010, gross fixed capital formation in machinery and equipment was reduced further (–2 percent) due to the strong underutilisation of capacity. It is expected to recover gradually (+4.8 percent per year) as exports of goods increase. The construction industry will not be able to return to the growth rates seen in the five-year period before the crisis, when civil engineering in particular expanded strongly. The investment projects of state-owned enterprises (the Federal Real Estate Corporation BIG, ASFINAG and the Austrian Federal Railways ÖBB) which were put into effect in 2010 and supported construction activity could not offset the decline in private residential construction, so that construction investment declined by 4 percent in 2010. For the period from 2011 to 2015 an increase of construction investment by about 1.2 percent per year is projected.

Figure 3: Expenditure on GDP and income

As a percentage of GDP, at current prices



Source: Statistics Austria, WIFO calculation.

In 2009 and 2010, consumption expenditure was stimulated by the tax reform and the expansion of government transfers and thus contributed to the stabilisation of the economy. In 2011-2015 private consumption will increase by 1.2 percent per year. Following the increase by 3 percentage points in 2002-2009 to slightly more than 11 percent the savings ratio is likely to decline to 10 percent in 2012 and then rise slightly again.

Following the 3.9 percent decline of real GDP in 2009 caused by the recession the economy expanded by around 2 percent in 2010. In the course of the next five years the Austrian economy is projected to grow by an annual average of 2.2 percent. After falling by 3.1 percent in 2009 nominal output increased by 3.2 percent in 2010 and will expand by 3.9 percent per year thereafter.

Trend growth is estimated applying a production function approach (*Kaniovski et al.*, 2008). In the ten years before the crisis real trend output expanded by 2¼ percent annually. As the recession caused investment activity to collapse in 2009 and 2010, the trend capital stock contracted. The trend component of hours worked increased more slowly in 2009 (+0.8 percent) than in previous years and will return to a trend growth of 1 percent in 2010 and 2011. However, it is expected that it will then slow to 0.7 percent annually. Factor-specific technical progress will be achieved via an improvement of the employed human capital (by an increase of the share of university graduates) and via raising the share of information and communication technology in the capital stock. Over the forecast period the increase in the share of university graduates in the workforce slows down slightly. The share of information and communication technology is assumed to remain constant from 2011 onwards. Both sources of factor-specific technical progress are expected to dampen productivity growth in the forecast period.

Under the assumptions described above the growth rate of real trend output slowed to 1.7 percent in 2010 and will not exceed this number until the end of the forecast period.

The real output gap – measured as percentage deviation of current output from trend output – was positive between 2007 and 2008 (2.2 percent) and worsened to –3.4 percent and –3.1 percent of trend output in 2009 and 2010, respectively. By the end of the forecast period this gap is expected to decline to –0.8 percent. This development marks the largest deviation from trend output since the beginning of the estimation period in 1976.

Cyclical recovery and consolidation reduce the budget deficit

Due to the envisaged measures to consolidate public finances as well as the cyclical improvement of tax revenues the budget deficit is expected to fall below 2 percent of GDP by the end of the forecast period. However, this development is impaired by the fact that fundamental structural reforms in the areas of health care, public administration and the organisation of the state (reform of federalism) as well as subsidies remain to be implemented.

To mitigate the impact of the financial and economic crisis on the real economy the Austrian federal government also enacted two stimulus and labour market packages[4] for the crisis years 2009-10. These measures were complemented by extensive provisions to stabilise financial markets. In addition to the effects of the automatic stabilisers, higher public expenditure measures already enacted before the crisis[5] as well as the reform deadlog in areas of strong expenditure increases (such as health care, pensions, public administration; *Aiginger – Pitlik – Schratzenstaller,* 2010) these lead to a substantial worsening of public finances. The general government deficit surged from 0.5 percent of GDP in 2008 to 3.5 percent of GDP in 2009 and reached 4.1 percent of GDP in 2010. If no countermeasures were taken, an average budget deficit of about 4 percent and an increase of the debt ratio from around 60 percent in 2008 to more than 75 percent of GDP would be expected for the years 2011-2014.

Like the actual federal public framework the consolidation package, which the federal government enacted at the end of 2010, refers to the period from 2011 to 2014 and determines the medium-term budget trend. The total of the consolidation measures are going to increase from € 2.6 billion in 2011 (0.9 percent of GDP) to € 4.8 billion (1.5 percent of GDP) in 2014, the year of its full impact. Over the whole period the cumulative consolidation volume amounts to € 15.5 billion. Supported by

[4] For details on the measures of the stimulus packages as well as their estimated macroeconomic effects see *Breuss – Kaniovski – Schratzenstaller* (2009).

[5] Especially the "Anti-Inflation Package" of spring 2008 and the resolutions of the Nationalrat (the Austrian parliament) of September 2008; *Aiginger – Pitlik – Schratzenstaller* (2010) discuss the details of the measures and their effects on public finances.

the automatic improvement of the budget balance due to the expected pick-up of economic growth the envisaged consolidation measures will reduce the general government budget deficit below the Maastricht upper limit of 3 percent of GDP. A reduction below 2 percent of GDP by 2015 seems within reach.

However, in view of the extent of the cyclical improvement the targeted medium-term budget trend seems cautious. The deficit is indeed pushed below the Maastricht limit a year earlier than recommended by the European Commission (albeit under much more pessimistic assumptions about medium-term economic activity; *European Commission*, 2009B, 2009C). Further consolidations steps after 2012 are modest and the European Commission's recommendation to also reduce the structural deficit in annual steps of 0.5 percent of GDP is not fully adhered to.

Almost half of the consolidation package consists of tax increases, including excises or transaction taxes, a bank levy and the increase of some wealth-related taxes. Slightly more than 50 percent are composed of spending cuts in the federal budget, which affect all departments. The federal government expects a stabilisation of the debt ratio at around 72 percent of GDP from 2013.

Furthermore, a broader view of the debt situation of the government has to take the extra-budgetary debts into account: during 2007-2011 the financial liabilities of the largest state-owned enterprises (the Federal Austrian Railways ÖBB, ASFINAG, the Federal Real Estate Corporation BIG) increase from 8.7 percent of GDP to 12.4 percent of GDP. The off-budget debts of the Länder and municipalities have to be added as well. Their long-term liabilities[6] amount to 5 percent of the GDP in 2011.

Table 4: General government

Current prices

	Ø 2000-2005	Ø 2005-2010	Ø 2010-2015	2010	2011	2012	2013	2014	2015
					Year-to-year percentage changes				
Current revenue	+ 2.5	+ 3.1	+ 3.9	+ 2.6	+ 4.0	+ 3.3	+ 3.8	+ 4.0	+ 4.1
Current expenditure	+ 2.5	+ 4.1	+ 2.9	+ 3.8	+ 2.0	+ 2.5	+ 3.2	+ 3.5	+ 3.5
Gross domestic product	+ 3.3	+ 3.1	+ 3.9	+ 3.2	+ 3.8	+ 3.8	+ 3.8	+ 4.0	+ 4.0
	Ø 2001-2005	Ø 2006-2010	Ø 2011-2015	2010	2011	2012	2013	2014	2015
					As a percentage of GDP				
General government financial balance (Maastricht definition)	– 1.6	– 2.0	– 2.4	– 4.1	– 3.1	– 2.7	– 2.4	– 2.1	– 1.8

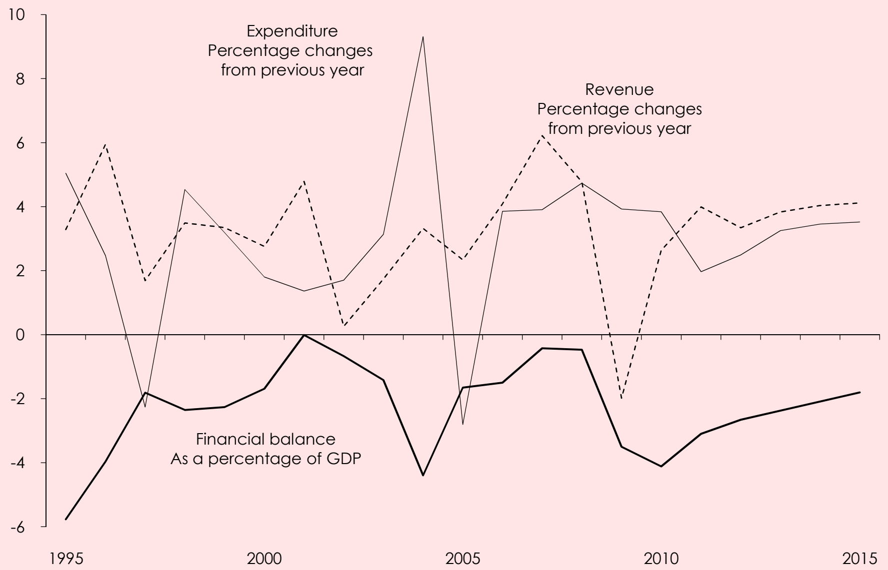
Source: Statistics Austria, WIFO calculations.

The increase in current expenditures, which reached 3.8 percent in 2010 due to economic stimulus measures and had amounted to 4.1 percent p.a. in the previous five-year period, will be slowed by the consolidation efforts over the forecast period. At an average of 2.9 percent per year expenditure growth will remain significantly below nominal GDP growth (+3.9 percent per year). However, the measures enacted so far can hardly curb the dynamic increase of expenditures in those areas which act as long-term cost drivers. Ensuring long-term financial sustainability of public finances requires fundamental structural reforms, particularly in the areas of health care (especially hospitals), public administration and the organisation of the state (reform of federalism) as well as subsidies. These reforms could yield substantial expenditure reductions in the medium term (*Pitlik – Budimir – Gruber*, 2010), which are not only necessary to meet the medium-term consolidation requirements. In addition, they are indispensable in the long run to meet the challenges to public finances resulting from climate change, an ageing population and the structural change towards a knowledge economy.

[6] Liabilities of the Länder as of the end of 2009 and liabilities of municipalities as of the end of 2008.

Public revenues had plummeted in 2009 due to the crisis and because the income tax reform had been brought forward to stabilise the real economy. Contrary to initial expectations tax revenues already recovered in 2010 (+2.6 percent) owing to the faster improvment in economic activity. Excise taxes in particular proved a major factor for the stabilisation of tax revenues. This reflects the stable trend of private consumption expenditure despite the crisis. However, profit taxes (assessed income tax and corporate tax) also expanded surprisingly fast in 2010. In 2011-2015, total government revenues will grow by 3.9 percent per year. A particularly strong rise is expected for revenues from VAT (steady growth of private consumption), wage tax (expansion of employment, increase of wages and salaries per employee) as well as profit taxes.

Figure 4: Revenue, expenditure and financial balance (according to Maastricht) of general government



Source: Statistics Austria, WIFO calculation.

To what extent the consolidation of public finances impairs growth and employment in the medium term, crucially depends on whether it is embedded in an overall strategy. Under certain conditions the phase of negative aggregate demand effects, which can hardly be avoided in the short run, can be limited, and positive effects of a sustainable budget consolidation might dominate in the medium term (*Aiginger – Schratzenstaller,* 2010). For this purpose at first the design of the consolidation strategy has to be credible and sustainable. Secondly, expenditure cuts should preponderate and one should abstain from reductions of long-term investments (education, research and development, science, environment). Next to efficiency improvements by a reorganisation of these administrative units, expenditure increases are rather recommended for these areas (activating component). Thirdly, if tax increases are also to contribute to the consolidation – which is justified inter alia by considerations of fairness – then the emphasis should be on those kind of taxes that have the least dampening effects on employment and growth and do not harm aggregate demand. Preferably they should provide a double dividend and mitigate the increasing inequality in the distribution of income and wealth. In its consolidation measures the federal government adheres to these principles only to a minor extent. The consolidation efforts include a number of individual ad hoc measures, which remain to be integrated into structural reforms of expenditures as well as an ecological and social tax reform that spurs growth and employment.

The budget forecast is subject to some risks and uncertainties. Firstly, it assumes that the enacted consolidation measures will be implemented to the expected extent. It also assumes that the combined deficit[7] of the Länder and the municipalities will not exceed the level of 0.6 percent of GDP during the coming years which is expected by the federal government. In view of the deficits of 2009 and 2010 of almost 1 percent of GDP, however, stronger efforts of the Länder and municipalities are required to meet this objective. The intensity of the consolidation efforts of different levels of government will depend not least on the renegotiation of the Austrian stability pact, which has been postponed to spring 2011 though. Additional financing requirements from those banks which were nationalised in an emergency move (such as Hypo Alpe Adria Group) cannot be ruled out and would put the budget under strain. In addition, an increase of interest rates on government debt due to the sovereign debt crisis in the euro area cannot be excluded. Owing to the net borrowing requirements it would significantly affect interest payments. If a potential exacerbation of the debt crisis in the euro area is counteracted via intensified consolidation measures, this could dampen aggregate demand and consequently the recovery of business activity in the euro area. As a consequence the economic expansion in Austria, too, would be impaired and the balancing of government budgets would be delayed.

No improvement in the labour market

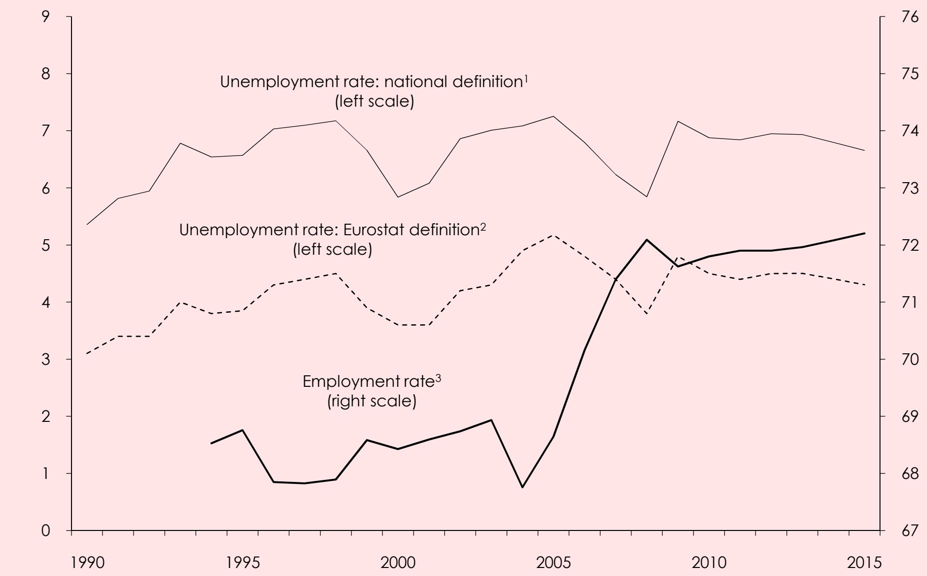
The unemployment rate (according to the Public Employment Service Austria, AMS) will amount to 6.8 percent on average during 2011-2015. Following the favourable trend in 2010 the number of registered unemployed persons is likely to rise to 257,000 by 2013 owing to the expansion of the labour supply. It is expected to decline slightly to 250,000 until the end of the forecast period.

In the upswing between 2003 and 2008 the number of employees expanded strongly at 1.6 percent per year. Both full-time and part-time employment increased significantly, and the share of part-time employees has risen above the EU average. Owing to the economic crisis the number of employees declined by 1.4 percent in 2009 (manufacturing: –6.0 percent). Without the taken labour market policy actions this decrease would have turned out much more severe (*Breuss – Kaniovski – Schratzenstaller*, 2009, *Mahringer*, 2009). In 2010, the labour market situation improved considerably owing to the improvment in economic activity. Despite excess employment due to labour hoarding in the previous year the number of employees increased by 1 percent (in manufacturing, however, it decreased by another 1.3 percent) and, compared to 2009, the unemployment rate diminished by 0.3 percentage points to 6.9 percent. The number of registered unemployed persons decreased by almost 10,000 to an average annual level of 251,000. However, it still exceeded the level of 2008 by 38,000. The expected GDP growth of 2.2 percent p.a. in real terms is expected to facilitate an expansion of the number of employees by an average of 0.6 percent per year during 2011-2015. However, it will not be sufficient to reduce the unemployment rate any further, especially as the supply of foreign and domestic workers will grow substantially, too (+0.6 percent per year).

From May 2011, all workers from the new EU countries will enjoy full labour mobility (for Romania and Bulgaria this will apply from 2014, if Austria makes use of the full transition period of 7 years). Already in 2009, the access to the Austrian labour market was partly liberalised for skilled workers from the new EU countries. So far, the inflow of workers from these ten countries that acceded to the EU in 2004 has been weaker than expected before the accession. The largest flows of migrants from these countries affected the UK and Ireland. After the expiry of the transition period this trend is not expected to continue at the previous pace. However, the supply of workers from these countries will exceed the level of the previous years from May 2011 onwards (and after January 2014, respectively). Nevertheless, a particularly strong influx of workers to the Austrian labour market is not expected. The actual extent of immigration from the new EU countries will strongly depend on employment opportunities (especially in tourism, retail trade and construction) and thus mainly on economic trends in Austria, but also on growth in the neighbouring countries in Central and Eastern Europe. Despite largely positive economic trends in these countries (especially in the border regions of Slovakia) since their EU accession in 2004 wage differentials between Austria and the new EU countries are still large enough to make employment in Austria attractive.

[7] Both the medium-term fiscal framework and the draft federal budget for 2011 envisage a total annual net borrowing by the *Länder* and local governments of 0.6 percent of GDP until 2014.

Figure 5: Labour market trends



Source: Labour Market Service, WIFO calculation. – [1] As a percentage of total labour force exclusive self-employed; according to Public Employment Service Austria. – [2] As a percentage of total labour force; according to Eurostat Labour Force Survey. – [3] Persons in employment as a percentage of population of working age (15 to 64 years).

Table 5: Labour market, income

	Ø 2001-2005	Ø 2006-2010	Ø 2011-2015	2010	2011	2012	2013	2014	2015
					In percent				
Unemployment rate									
Eurostat definition[1]	4.4	4.5	4.4	4.5	4.4	4.5	4.5	4.4	4.3
National definition[2]	6.9	6.6	6.8	6.9	6.8	6.9	6.9	6.8	6.7
	Ø 2000-2005	Ø 2005-2010	Ø 2010-2015	2010	2011	2012	2013	2014	2015
					Year-to-year percentage changes				
Persons in active dependent employment[3]	+ 0.4	+ 1.1	+ 0.6	+ 1.0	+ 0.6	+ 0.5	+ 0.6	+ 0.7	+ 0.7
Registered unemployed	+ 5.4	– 0.2	– 0.1	– 3.7	± 0.0	+ 2.2	+ 0.3	– 1.4	– 1.5
Productivity[4]	+ 1.1	+ 0.4	+ 1.5	+ 1.0	+ 1.5	+ 1.5	+ 1.4	+ 1.5	+ 1.5
Gross wages and salaries[5]	+ 2.4	+ 3.8	+ 3.2	+ 2.5	+ 2.8	+ 2.8	+ 3.2	+ 3.4	+ 3.7
Per employee[6]	+ 1.9	+ 2.4	+ 2.5	+ 1.4	+ 2.0	+ 2.3	+ 2.5	+ 2.7	+ 2.9
Unit labour costs, total economy	+ 0.7	+ 2.0	+ 1.0	+ 0.6	+ 0.5	+ 0.8	+ 1.1	+ 1.1	+ 1.4

Source: Federation of Austrian Social Security Institutions, Statistics Austria, WIFO calculations. – [1] According to Eurostat Labour Force Survey, percent of total labour force. – [2] According to Public Employment Service Austria, percent of total labour force excluding self-employed. – [3] Excluding parental leave, military service, and unemployed persons in training. – [4] Real GDP per employment (dependent and self-employed according to National Accounts definition). – [5] Excluding employers' contributions. – [6] Employees according to National Accounts definition.

According to the present forecast the number of unemployed persons will rise to just above 257,000 by 2013 (+6,400 compared to 2010) and then diminish slightly (–7,600 by 2015). For the period 2011-2015 on average an unemployment rate of 6.8 percent of the dependent labour force and 4.4 percent of the labour force according to the Eurostat definition is projected, respectively. The unemployment rate, too, is expected to decrease marginally only at the end of the forecast period (to 6.7 percent).

Inflation accelerates slightly

In recent years the trend of the inflation rate strongly depended on the movements of international crude oil and other commodity prices. Both the increase of the inflation rate (as measured by the consumer price index) to almost 4 percent in the course of 2008 (3.2 percent on average for the year) and the decrease to –0.3 percent in July 2009 (annual average: +0.5 percent) and also the recent increase to 1.8 percent in 2010 were essentially caused by the fluctuations of the prices of mineral oil products. During the last three years core inflation fluctuated between 0.9 percent and 2.9 percent (*Baumgartner,* 2009).

The projection assumes that the price of crude oil rises from $ 79 per barrel in 2010 to $ 105 per barrel in 2015 and the prices of other commodities (agricultural and mining commodities) will increase by 3.7 percent per year in US dollar terms. For the euro-dollar exchange rate a depreciation from $ 1.33 per euro in 2010 to $ 1.20 in 2012 and a subsequent appreciation to $ 1.35 per euro is assumed. World market prices of manufactured goods (in US dollar terms) are assumed to increase by merely 0.5 percent per year (*Schulmeister,* 2011, in this issue).

Table 6: Implicit price indices

	Ø 2000-2005	Ø 2005-2010	Ø 2010-2015	2010	2011	2012	2013	2014	2015
					Year-to-year percentage changes				
Private consumption	+ 1.7	+ 1.7	+ 1.9	+ 1.8	+ 2.1	+ 1.8	+ 1.9	+ 1.9	+ 1.9
Exports	+ 0.7	+ 1.8	+ 1.4	+ 3.1	+ 2.0	+ 1.5	+ 1.3	+ 1.2	+ 1.2
Imports	+ 0.5	+ 2.3	+ 1.8	+ 3.9	+ 2.8	+ 1.6	+ 1.6	+ 1.5	+ 1.5
Gross domestic product	+ 1.6	+ 1.6	+ 1.7	+ 1.2	+ 1.5	+ 1.8	+ 1.6	+ 1.7	+ 1.8

Source: Statistics Austria, WIFO calculations.

As part of the measures to consolidate the budget some indirect taxes are raised in 2011 (mineral oil tax, tobacco tax, CO_2-surcharge in the standard fuel consumption tax, introduction of an air ticket tax). Including the ensuing additional VAT revenues (broadening the tax base) these tax increases contribute about 0.4 percentage points to inflation in 2011. The inflation rate will surge to 2.1 percent.

In addition to movements of energy and commodity quotations as well as changes in indirect taxes and fees, unit labour cost trends as well as competition policies determine price trends. Domestic factors will have only minor effects on inflation in the near future. Wages will react to the slight increase in inflation and the improved labour market conditions: in the forecast period 2011-2015 the annual increase of nominal wages per capita is expected to accelerate from 2.0 percent to 2.9 percent. Unit labour costs of the whole economy, the most important determinant of domestic cost pressure will increase by 1 percent per year in 2011-2015. Following a decrease by 0.4 percent in 2010 real wages per employee are expected to rise steadily by 0.5 percent per year until 2015. As a consequence the differential with respect to the trend of labour productivity diminishes from 1.4 to 0.6 percentage points. In the coming years inflation will accelerate. For the period from 2011 until 2015 an average inflation rate of 1.9 percent is expected.

Risks and uncertainties

This medium-term forecast for Austria rests on the assumption that the international real economy overcomes the consequences of the financial and economic crisis and there is no new setback to economic activity. If international business activity (especially in the euro area) does not pick up to the expected extent (e.g., due to a massive escalation of the sovereign debt crisis in the euro area or a strong increase of commodity prices), this would also impair the recovery of the Austrian economy. Further, financial markets and the banking system are still in a fragile condition.

In addition, methodological problems in the use of an econometric forecast model lead to constraints. In principle the majority of the estimated parameters of the model are based on the estimation period 1976-2008 (i.e., before the outbreak of the financial and economic crisis of 2009-10). If the behaviour of economic agents (corporations, private households, government in Austria and abroad) has changed permanently, this is not taken into account due to a lack of corresponding data.

References

Aiginger, K., Pitlik, H., Schratzenstaller, M., "Options for the Consolidation of Public Budgets in Austria", Austrian Economic Quarterly, 2010, 15(2), pp. 184-197, http://www.wifo.ac.at/wwa/pubid/40179.

Aiginger, K., Schratzenstaller, M., "Budgetkonsolidierung unter schwierigen Rahmenbedingungen. Zehn Leitlinien und erste Erfahrungen in der EU", WIFO-Monatsberichte, 2010, 83(12), pp. 941-954, http://www.wifo.ac.at/wwa/pubid/40977.

Baumgartner, J., "The Effects of the Financial Market and Economic Crisis on Inflation", Austrian Economic Quarterly, 2010, 15(1), pp. 98-102, http://www.wifo.ac.at/wwa/pubid/39076.

Baumgartner, J., Breuss, F., Kaniovski, S., "WIFO-Macromod. An Econometric Model of the Austrian Economy", in OeNB (Ed.), "Macroeconomic Models and Forecasts for Austria", Proceedings of OeNB Workshops, 2005, (5), pp. 61-86.

Breuss, F., Kaniovski, S., Schratzenstaller, M., "Macro-economic Effects Of the Fiscal Stimulus Measures in Austria", Austrian Economic Quarterly, 2009, 14(4), pp. 205-216, http://www.wifo.ac.at/wwa/pubid/37561.

Ederer, St., "Cyclical Upturn Set to Continue, With Risks Persisting. Economic Outlook for 2011 and 2012", Austrian Economic Quarterly, 2011, 16(1), pp. 1-12, http://www.wifo.ac.at/wwa/pubid/41180.

European Commission (2009A), "Impact of the Current Economic and Financial Crisis on Potential Output", European Economy, Occasional Paper, 2009, (49).

European Commission (2009B), "Excessive Deficit Procedure Steps: The Stability and Growth Pact as the Anchor for Fiscal Exit Strategies", Press release IP/09/1694, 11 November 2009.

European Commission (2009C), Austria – Commission Assessment in Relation to the Commission Recommendation for a Council Decision and Recommendation under Articles 104.6 and 104.7 of the Treaty, Brussels, 2009, http://ec.europa.eu/economy_finance/publications/publication16188_en.pdf.

European Commission, "European Economic Forecast – Autumn 2010", European Economy, 2010, (7), http://ec.europa.eu/economy_finance/publications/european_economy/2010/pdf/ee-2010-7_en.pdf.

FIW, Österreichs Außenwirtschaft 2010, Vienna, 2010, http://www.wifo.ac.at/wwa/pubid/41015.

Gaggl, P., Janger, J., "Wird die aktuelle Rezession nachhaltige Auswirkungen auf das Produktionspotenzial in Österreich haben?", Geldpolitik und Wirtschaft, 2009, (Q3), pp. 27-57, http://www.oenb.at/de/img/gewi_2009_q3_analyse02_tcm14-142507.pdf.

Exports Drive Growth – Domestic Demand Remains Subdued

Medium-term Projections for the Austrian Economy until 2015 – Summary

Led by a dynamic export growth real GDP in Austria grew by 2 percent in 2010. Between 2011 until 2015 the Austrian economy is expected to grow by 2.2 percent. The annual growth rate of trend output will average at 1.7 percent in the forecast period, ½ percentage point below the average of the 10 years before the crisis.

The world economy has overcome the cyclical trough sooner than anticipated and expanded by 4.5 percent in 2010. This growth rate is expected to persist during the period from 2011 to 2015. The revival of world trade will cause an increase of Austrian exports by an average of 6.2 percent per year. As import growth is slightly lower at 5.8 percent, net exports will contribute to GDP growth. The pick-up in export activity in 2010 failed to spur investment (–3.1 percent) sufficiently as capacity utilisation remained low at the beginning of the year. Owing to the sustained and dynamic export growth, investment activity is expected to pick up in the forecast period and gross fixed capital formation will expand by an average of 2.9 percent per year.

The economic policy measures that came into effect in 2009 and 2010 propped up real disposable income of households and stabilised the domestic demand by an increase of private consumption expenditure. For the years 2011-2015 private consumption is forecast to expand by 1.2 percent per year. The savings ratio is expected to rise again from 2013 onwards.

The economic policy measures aimed at mitigating the economic crisis as well as the cyclical decline in tax revenues have made the budget deficit rise to 3.5 percent and 4.1 percent in 2009 and 2010, respectively. Due to the consolidation and the improvement of the economic situation a reduction of the deficit ratio below 2 percent of GDP by 2015 seems within reach. To curb the growth in public spending in the long run, fundamental structural reforms in health care, public administration and subsidies are necessary.

In the wake of the economic crisis of 2009 the number of employees declined by 1.4 percent despite countervailing labour market policies. The number of unemployed persons (an annual average of 260,000 persons) reached the highest level since the middle of the 1950s and the unemployment rate equalled 7.2 percent. The revival of economic activity in 2010 lead to an increase in the number of employees by 1 percent and reduced the unemployment rate by 0.3 percentage points. The number of employees will rise by 0.6 percent per year in 2011-2015. As the domestic and the foreign supply of labour will expand roughly at the same rate, labour market conditions are not likely to ease further until 2014. The unemployment rate is expected to remain at 6.8 percent on average.

Following a fall in commodity prices from mid-2008 until early 2009 the trend in international commodity markets reversed. In the coming years the prices of crude oil and other commodities will continue to rise. The increase in indirect taxes in the course of the fiscal consolidation will raise the inflation rate by 0.4 percentage points to 2.1 percent in 2011. Hardly any inflationary effects are expected from other domestic factors in the coming years. An average annual inflation rate of 1.9 percent is expected for Austria in 2011-2015.

Guger, A., Leoni, T., "International Unit Labour Cost Position Improved in 2006", Austrian Economic Quarterly, 2007, 12(4), pp. 189-198, http://www.wifo.ac.at/wwa/pubid/30980.

Hölzl, W., Leoni, T., Zulehner, C., "Internationale Lohnstückkostenposition 2008 leicht verbessert", WIFO-Monatsberichte, 2009, 82(9), pp. 703-714, http://www.wifo.ac.at/wwa/pubid/36769.

IMF, World Economic Outlook, October 2009. Chapter 4: What's the Damage? Medium-term Output Dynamics after Financial Crisis, Washington D.C., 2009, pp. 121-151, http://www.imf.org/external/pubs/ft/weo/2009/02/pdf/c4.pdf.

Kaniovski, S., Pitlik, H., Steindl, S., Url, T., "A Decomposition of Austria's General Government Budget into Structural and Cyclical Components", WIFO Working Paper, 2008, (316), http://www.wifo.ac.at/wwa/pubid/31859.

Mahringer, H., "Labour Market Development During the Financial Market and Economic Crisis", Austrian Economic Quarterly, 2010, 15(1), pp. 109-120, http://www.wifo.ac.at/wwa/pubid/39082.

Pitlik, H., Budimir, K., Gruber, N., "Options for Budget Consolidation on the Expenditure Side", Austrian Economic Quarterly, 2010, 15(2), pp. 211-230, http://www.wifo.ac.at/wwa/pubid/40181.

Schulmeister, St., "Kräftige Erholung der Weltwirtschaft. Mittelfristige Prognose bis 2015", WIFO-Monatsberichte, 2011, 84(1), pp. 37-48, http://www.wifo.ac.at/wwa/pubid/41149.

Steindl, S., "Potentialwachstum in Österreich. Schätzung und Diskussion der angebotsseitigen Wachstumschancen", WIFO-Monatsberichte, 2006, 79(12), pp. 881-891, http://www.wifo.ac.at/wwa/pubid/27902.

Walterskirchen, E., "The Burst of the Real Estate Bubble – More Than a Trigger for the Financial Market Crisis", Austrian Economic Quarterly, 2010, 15(1), pp. 86-93, http://www.wifo.ac.at/wwa/pubid/39074.