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RECOVERY EASES BUDGET PROBLEMS AND ACCELERATES EMPLOYMENT GROWTH

ECONOMIC OUTLOOK FOR 1998 AND 1999

The economic recovery in Austria is projected to gain momentum in 1998 and 1999. With economic activity in Austria again expanding at the same rate as in the EU, growth is expected to accelerate to 2¾ percent and 3 percent in real terms. The gradual strengthening of domestic demand will relieve the labor market as well as the budgets of the public sector, but inflation will remain subdued.

During the period from 1990 and 1996, economic growth in Austria was slightly less than 2 percent per year in real terms, about as high as in Germany and ½ percentage point higher than in the EU. Thus, Austria's economy managed to cope relatively well with various challenges, such as the opening of the East and accession to the EU. According to preliminary estimates, demand and production expanded by 1¾ percent during the first three quarters of 1997. The whole year of 1997 is likely to see a real growth rate of at least 2 percent. Merchandise exports, the main force of this expansion, soared by about 10 percent on a year-on-year basis.

The export-led recovery is likely to continue into 1998 and 1999. The recovery, which is spreading from the export sector to other sectors of the economy, will be weakened only slightly by the crisis in Asia. Demand from the trading partners in East-Central Europe is likely to remain strong, that from western Europe will even gain momentum. Under the assumption of stable foreign exchange rates within the EMS and an easy transition to the Monetary Union, Austria's exporters will maintain their competitive position in international trade, and the volume of merchandise exports will expand by 9 percent each year. Import growth will be sluggish in 1997, but will accelerate in the following years as domestic demand strengthens. The deficit in the trade account will decline to ATS 90 billion, while the current account deficit will stabilize at the level of ATS 45 billion (1¾ percent of GDP). A substantial part of the deficit is due to net payments to the EU and to deficits in the balance of factor

All staff members of the Austrian Institute of Economic Research contribute to the Economic Outlook.

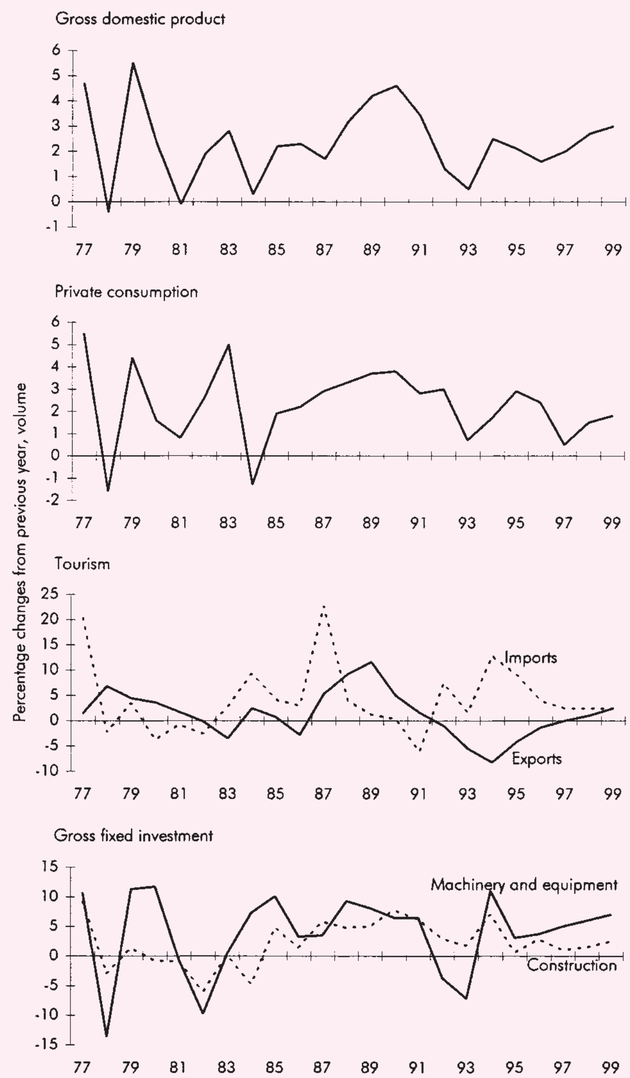
Table 1: Main results

		1995	1996	1997	1998	1999
		Percentage changes from previous year				
GDP						
Volume		+ 2.1	+ 1.6	+ 2.0	+ 2.7	+ 3.0
Value		+ 4.2	+ 3.7	+ 3.2	+ 4.0	+ 4.5
Manufacturing[1], volume		+ 1.0	+ 1.2	+ 4.0	+ 4.5	+ 4.5
Private consumption, volume		+ 2.9	+ 2.4	+ 0.5	+ 1.5	+ 1.8
Gross fixed investment, volume		+ 1.9	+ 2.4	+ 2.8	+ 3.6	+ 4.6
Machinery and equipment		+ 3.1	+ 3.7	+ 5.0	+ 6.0	+ 7.0
Construction		+ 0.6	+ 2.8	+ 1.0	+ 1.5	+ 2.5
Exports of goods[2]						
Volume		+ 12.1	+ 5.3	+ 10.0	+ 9.0	+ 9.0
Value		+ 13.2	+ 5.5	+ 11.1	+ 10.6	+ 10.6
Imports of goods[2]						
Volume		+ 5.7	+ 6.1	+ 6.5	+ 7.5	+ 8.0
Value		+ 6.2	+ 6.7	+ 8.1	+ 9.4	+ 9.6
Trade balance[2]	billion ATS	– 88.0	–100.6	– 90.3	– 90.7	– 91.8
Current balance	billion ATS	– 47.0	– 43.4	– 45.5	– 45.4	– 43.3
As a percentage of GDP	in percent	– 2.0	– 1.8	– 1.8	– 1.7	– 1.6
Long-term interest rate[3]	in percent	7.1	6.3	5.7	5.7	5.9
Consumer prices		+ 2.2	+ 1.9	+ 1.4	+ 1.5	+ 1.5
Unemployment rate						
Percent of total labor force[4]	in percent	3.9	4.4	4.4	4.3	4.2
Percent of dependent labor force[5]	in percent	6.6	7.0	7.1	7.1	6.9
Dependent employment[6]		+ 0.0	– 0.6	+ 0.4	+ 0.6	+ 0.9

[1] Value added, including mining and quarrying. – [2] According to Central Statistical Office. – [3] 10-year central government bonds (benchmark). – [4] According to Eurostat. – [5] According to labor exchange statistics. – [6] Excluding parental leave and military service.

Figure 1: Demand and output

Percentage changes from previous year, volume



income; the imbalance therefore reflects only partially a weakness in the competitive position.

With exports soaring, manufacturing output expanded strongly (+4½ percent); further impulses will stem from consumer demand in 1998 and 1999. Employment will record hefty gains over the next two years. Fiscal policy is becoming less restrictive and real disposable income will increase for the first time in two years, providing some leeway for growth in private consumption (1998 +1½ percent, 1999 +1¾ percent). The construction industry will emerge only gradually from the current slack, but new financing models and outsourcing of activities previously performed by the municipalities could stimulate the civil engineering sector. The construction of new dwellings will decline, while renovation and modernization activity will continue to be brisk. Non-residential construction (such as in tourism) might benefit from the economic upturn.

The acceleration of economic growth has a positive impact on the labor market. Demand for labor (excluding persons in military service and on parental leave) will rise by 18,000 persons in 1998 and by 27,000 persons in 1999 (+0.6 percent and +0.9 percent). The trend toward working time flexibility will continue; women will benefit disproportionately from the employment expansion in the service sectors. The growth in labor demand will be matched almost completely by an expansion in labor supply for the "hidden labor reserve". Thus, unemployment will decline only slightly. In 1999, there will be 229,000 persons without a job; this implies an unemployment rate of 6.9 percent of the dependent labor force according to the traditional Austrian method of calculation and a rate of 4.2 percent of the total labor force according to Eurostat. 63 percent of the Austrian working-age population participate in economic activity. In a comparison among European countries, Austria exhibits not only one of the lowest unemployment rates but also one of the highest labor force participation rates (which counts as employed also the growing number of persons in precarious employment).

Inflation remains subdued. As in previous years, the effects of Austria's accession to the EU continue to dampen inflation, with the effects being increasingly felt in the service sector. The rising supply of new housing has tended to lower rents charged for newly let apartments. The effects of increases in raw materials prices and in exchange rates are fading. The rise in public charges will, however, fuel inflation in 1998. In 1998 as well as in 1999, consumer prices will rise by around 1½ percent. Nominal wage gains will remain small in 1997 and 1998, but accelerate to 2¾ percent in 1999. Nevertheless, net real income gains per employee will stagnate in 1999, after two years of substantial decline.

The financial situation of the public sector continues to be determined by broad-based efforts to consolidate the budgets. Austria easily meets the fiscal criteria for membership in the Monetary Union; the deficit of the general government financial balance in 1997 is forecast to improve to –2.6 percent of GDP. In the subsequent years, the economic recovery will boost tax revenues, particularly those from income taxes on salaries and wages. The financial balance is likely to improve to –2.1 percent by 1999; this development is in accordance with the path agreed upon in the "EU Stability Pact", but leaves little maneuvering room on the revenue and expenditure side.

Table 2: World economy

		1995	1996	1997	1998	1999
		Percentage changes from previous year				
Real GDP						
Total OECD		+ 2.2	+ 2.6	+ 2.8	+ 2.5	+ 2.5
USA		+ 2.0	+ 2.8	+ 3.8	+ 2.5	+ 2.0
Japan		+ 1.4	+ 3.5	+ 0.5	+ 1.0	+ 1.5
EU		+ 2.5	+ 1.7	+ 2.5	+ 2.8	+ 3.0
Germany		+ 1.9	+ 1.4	+ 2.3	+ 2.8	+ 3.0
Eastern Europe		+ 5.4	+ 4.7	+ 4.3	+ 4.5	+ 5.0
World trade, volume		+ 9.5	+ 6.2	+ 9.0	+ 8.0	+ 7.5
OECD exports		+ 8.6	+ 6.4	+10.3	+ 8.0	+ 7.5
Intra-OECD trade		+ 5.5	+ 6.6	+11.0	+ 9.5	+ 8.0
Market growth[1]		+ 6.1	+ 6.2	+ 7.8	+ 7.6	+ 7.6
Primary commodity prices, in US$						
HWWA index, total		+10.0	+ 3.0	– 1.0	± 0.0	+ 1.0
Excluding energy		+11.0	– 9.0	+ 6.5	+ 5.0	± 0.0
Crude oil prices						
Average import price (cif) for OECD countries	US$/barrel	17.2	20.6	19.0	18.0	18.5
Exchange rate	ATS/US$	10.08	10.59	12.10	12.30	12.30

[1] Real import growth of trading partners weighted by Austrian export shares.

BASIS OF EUROPEAN RECOVERY WIDENS

The financial turbulences in South-East Asia will set off a downturn in the countries directly affected. In Japan, the fledgling recovery has come to a standstill. Growth in the USA and in Europe should be only moderately impaired. In Europe, the rebound is gaining momentum and is becoming more broadly based. Growth is likely to accelerate to 2¾ percent in 1998 and to 3 percent in 1999.

The financial crisis in South-East Asia has changed the fundamentals of the international economy. At present, the consequences of the turbulence in the financial markets cannot yet be predicted with accuracy; the financial markets remain unstable and it is unclear to what extent the banking system will be drawn into the crisis. The most important causes of the crisis were the decline in international competitiveness, the high current account deficits of the countries directly involved, as well as the formation of price bubbles in the South-East Asian property markets. The dramatic losses in the stock and real estate markets and the transition to a sharply restrictive monetary and fiscal stance will dampen economic growth and curtail imports of these countries in 1998. If the financial system in South-East Asia does not collapse, there is the potential for an economic rebound, which, given the devaluation of the currencies in these countries, would originate in the export sector.

For Japan, given the close financial and trade links with the crisis area (almost 50 percent of Japanese exports are shipped to Asian countries), the turmoil will seriously impair economic growth. The slump, moreover, has hit Japan at a tenuous phase of the business cycle, when the incipient recovery was gaining strength and economic policy was left with little maneuvering room. Thus, economic growth is unlikely to pick up in 1998, and the 1990s will go down in history as the decade of economic stagnation (with economic growth reaching no more than 1½ percent per year on average).

The crisis in South-East Asia, by dampening international trade, will also have an impact on other industrialized countries. The economies of the USA and of Europe, however, are in a much better position than the Japanese economy to cope with this disturbance: trade links with the troubled countries are significantly lower and the economic upswing is on firmer ground. In the USA the mainstay of lively economic activity is domestic demand. Investment expenditures have been boosted by the strong aggregate demand, the "revolution in information technology", the decline in prices of capital goods, and high earnings in the business sector. Consumer expenditures have benefited from the hefty expansion in employment. In 1997, U.S. economic growth, which is estimated to have reached a rate of almost 4 percent, was the driving force behind the world-wide recovery. In 1998 and 1999, as a result of the rise in the value of the dollar and the turmoil in South-East

Asia, economic growth in the USA is likely to be somewhat weaker (2½ and 2 percent), but strong enough to sustain the propitious development in the labor market and the favorable financial situation of the public sector.

In the EU, economic activity picked up in 1997; real GDP grew by 2½ percent. The EU average masks a great deal of diversity, however. Some countries (the U.K., Ireland, most of the Scandinavian countries, Spain, Portugal, and the Netherlands) are in the advanced stages of the business cycle. This may be due to the close trade linkage to the USA, the growth effects of past devaluations, or the less restrictive stance of fiscal policy. In these countries, the upswing has spread to domestic demand; economic growth was above the EU average and unemployment on the decline. GDP growth is projected to be around 3 percent in 1998 and 1999, with a marked slowdown expected only for the U.K.

In Germany, France, and some of the smaller countries, the upswing in 1997 was mainly supported by the improvement in the cost-determined competitiveness resulting from the devaluations since the spring of 1995 and so far limited mainly to the export sector. This is particularly noticeable in Germany, where the weakness of domestic demand has been a drag on the incipient upswing. Domestic orders in the investment goods industry have stagnated despite high earnings in the business sector. Private consumption has remained sluggish as a result of the gloomy situation in the labor market and of tight fiscal policy. Three preconditions must be met before economic growth can pick up again in Germany: entrepreneurial expectations, which have so far been shaped by uncertainty regarding future economic policy and adverse sales forecasts, must stabilize and support an expansion in investment; improvements in the labor market and real income gains must strengthen private consumption; the impact of the crisis in Asia on major projects pursued by large German manufacturing companies in these countries should not markedly affect other fields of business.

The upswing in the EU economies was rather diverse in 1997, but should become more broadly based in 1998 and 1999, with real GDP expanding at the rate of 2¾ and 3 percent. If aggregate demand and output continue to expand along this path, substantial relief can be expected for the labor market and the financial situation of the public sector.

The continuation of the current upswing should facilitate the transition to the Monetary Union. Nonetheless, the possibility of speculative movements in the foreign exchange markets and ensuing instabilities (with some spillover effects on economic growth) cannot be excluded for 1998, if the financial markets were to test the likelihood of the participation of some countries in the Monetary Union or the firmness of foreign exchange rates. The present forecast assumes, however, that the Monetary Union will be realized on January 1, 1999, with 11 member states participating. It is also assumed that the conversion rates will be the existing central rates. The transition to the EMU will entail a rapid convergence of the short-term interest rates in the participating countries. An increase in short-term interest rates must, therefore, be expected for the hard-currency countries. In Austria, the 3-month interest rate (VIBOR) is likely to rise from 3½ percent to more than 4 percent. The long-term interest rates need not be strongly affected by this adjustment in the short-term range.

In East-Central Europe, economic growth weakened in the wake of the stabilization programs undertaken in the Czech Republic and in Bulgaria. Similar measures can be expected in Poland, the Slovak Republic, and Romania. In contrast, the expansion in aggregate demand and output is gaining momentum in Hungary. Exports from the countries of East-Central Europe are likely to benefit from the acceleration of economic growth in western Europe; this in turn will boost economic growth in this area and allow some countries to ease import restrictions.

EXPORT BOOM IMPROVES TRADE BALANCE

Strong growth of export markets and a marked improvement in the competitive position of Austria's enterprises have triggered an export boom. Domestic demand and thus imports have recovered only gradually. The deficit in the trade balance fell to ATS 90 billion.

The appreciation of major currencies in tandem with a fall in unit labor costs and the gradual cyclical rebound of the economies of important trading partners have brought a welcome relief to Austria's export sector. According to statistics compiled by the Austrian Central Statistical Office, exports surged by 12 percent in the first half of 1997, with shipments to countries outside of the EU recording the highest growth rates. The competitive position of Austria's suppliers has improved substantially. The real effective exchange rate of the schilling for manufactures posted a gain of 2½ percent in the second consecutive year; unit labor costs (measured in a common currency) relative to those of the major trading partners declined by 4½ percent. Over the forecast period the improvement in the international cost position is expected to level off, however, even though absolute unit labor costs in Austria's manufacturing sector are likely to drop further as a result of high productivity growth and moderate wage increases.

Austrian exporters are likely to gain market shares also in 1998 and 1999. At the same time, the growth of export markets will remain strong. The vigorous demand from East-Central Europe and from some EU countries in which the recovery has become broad-based will be supplemented by import demand from Germany and Italy, where consumer and investment expenditures are expected to pick up. Thus, after a gain of 5 percent in 1996, merchandise exports will expand at the rate of almost 10 percent in real terms during the period from 1997 to 1999 per year and constitute the mainstay of the rebound. Stable exchange rates in the EMU will rule out the possibility that Austria's competitive position is eroded by the devaluation of the currencies of important trading partners.

The developments in the foreign exchange markets favored exports and production, but at the same time result in a rise in import prices and a deterioration of the terms of trade, which in turn tended to raise the trade deficit. Nonetheless, in 1997 nominal imports are estimated to have expanded less than exports. Given the comprehensive efforts to consolidate the budgets of the public sector, final domestic demand in 1997 exceeded the level in 1996 by only 1 percent, while total aggregate demand expanded three times as fast. This development markedly relieved the trade balance: the deficit decreased by ATS 10 billion to some ATS 90 billion (3½ percent of GDP). As domestic demand picks up in 1998, imports will also expand at a higher rate than in previous years, with growth in real terms accelerating from 6 percent in 1996 to 8 percent in 1999.

DEFICIT IN THE CURRENT ACCOUNT STABILIZES

The balance in the current account deteriorated steadily in the 1990s. In 1996, the deficit was as high as 1¾ percent of GDP. The main factor responsible for the downward trend was the decline in the surplus in the tourism balance. Austria's tourism industry suffered both from structural problems in summer tourism and from the development of foreign exchange rates. Starting in 1995, substantial deficits in the transfer balance, resulting from net payments to the EU, exacerbated the problem. In 1997, the current account deficit stabilized at ATS 45 billion, mainly as a result of the realignment of the foreign exchange rates and the weakness of domestic demand. The surplus in the tourism balance shrank again by ATS 6 billion to 16¾ billion. A rising surplus, which is already triple that in the tourism balance, is recorded by other services such as transport, transit trade, outward border processing.

Table 3: Productivity

	1995	1996	1997	1998	1999
	Percentage changes from previous year				
Total economy					
Real GDP	+2.1	+1.6	+2.0	+2.7	+3.0
Employment[1]	+0.2	–0.5	+0.4	+0.5	+0.8
Productivity (GDP per employment)	+1.9	+2.1	+1.6	+2.1	+2.1
Manufacturing					
Production[2]		+1.3	+4.0	+4.5	+4.5
Employees		–2.9	–1.4	–0.7	–0.3
Productivity per hour		+4.5	+6.0	+5.2	+4.8
Working hours per day for workers		–0.3	–0.6	±0.0	±0.0

[1] Dependent and self-employed according to National Accounts. – [2] Value added.

In 1998 and 1999, the current balance is not expected to improve markedly. The pick-up in domestic demand is likely to have a negative impact on the trade balance. The deficit in the transfer balance will also rise slightly, being determined mainly by net payments to the EU which are estimated to reach about ATS 15 billion per year. Net factor income are forecast to post a steady deficit of ATS 8 billion. Travel expenditures by Austrians abroad will continue to show vigorous growth (2½ percent in real terms). After stagnating in 1997, touristic demand by foreigners is expected to pick up slightly over the next few years. The tourism balance is likely to stabilize by 1999.

HEFTY EXPANSION OF MANUFACTURING OUTPUT

The lively demand from abroad has substantially boosted manufacturing output (1997 +4 percent in real terms). As domestic demand picks up economic buoyancy will spread to other production sectors.

After some delay occasioned by the revisions in the statistical surveys, data on manufacturing output for the first quarter of 1997 have become available for the first time. Partially adjusted for the number of working days, output rose by 5¾ percent on a year-on-year basis. This tendency is likely to continue during the rest of 1997. The WIFO business cycle survey suggests that the expansion of manufacturing output will accelerate: in the fourth quarter entrepreneurs were again more optimistic about domestic and foreign orders than in previous surveys, with the majority expecting a further increase in production over the next few months. Towards the end of 1997 the pick-up in economic activity may have shifted from the basic-goods sector and the chemical industry to the enterprises of technical manufacturing. Thus, manufacturing output is likely to have expanded by at least 4 percent in 1997. So far, the driving force has been foreign demand. In 1998, the upswing may gain momentum and spread to other sectors of the economy; the production of traditional consumer goods and the construction supplies industry, in particular, should benefit from the gradual rebound of domestic demand. Under these conditions, manufacturing output could easily accelerate to 4½ percent per year.

Austria's manufacturing industry has spent heavily on capital goods during the last few years, substantially more than the German manufacturing industry, as many enterprises were able to maintain their competitive position by modernizing their capital stock. Moreover, there were several huge investment projects in the paper and automobile components industry. In 1997, capital outlays are likely to grow as fast as in 1996. As the economy picks up momentum, the propensity to invest will also rise in small-scale industry and in various service sectors. Thus, the growth of investment in machinery and equipment is likely to accelerate gradually.

SLOW RECOVERY IN THE CONSTRUCTION SECTOR

In 1997, construction activity remained sluggish; the volume of construction put in place is likely to have expanded by only 1 percent. Owing to clement weather conditions, employment in the first half of the year exceeded the previous year's level by 2½ percent, but then dropped 0.4 percent below the level of the second half of 1996. The weakness of the construction industry is mostly the result of the austerity program implemented in the public sector: the municipalities' construction outlays were on the decline; the cuts in discretionary spending by the Federal government might have hit civil engineering projects particularly hard. In the medium term, however, the establishment of public sector entities and new models of financing public investment, such as the extension of the railroad foundations, promise a revival of the construction business. Residential housing construction, however, is headed for a decline. The surge in housing construction during the last few years has eliminated the excess demand. The number of permits for new dwellings in the subsidized housing sector has declined. The renovation and modernization business continues to thrive, however, as the result of tax incentives and direct public subsidies. There is ample office space available; construction in this sector will therefore remain subdued. A revival of construction activity can be expected in other sectors of commercial construction, such as in the tourist industry, which expects a modest rebound. The total volume of construction put in place in 1998 and 1999 is forecast to rise slightly (+1½ and 2½ percent).

Table 4: Earnings and international competitiveness

	1995	1996	1997	1998	1999
	Percentage changes from previous year				
Gross earnings per employee	+3.2	+1.7	+1.5	+2.0	+2.7
Gross real earnings per employee	+1.5	–0.8	±0.0	+0.3	+1.0
Net real earnings per employee	+0.5	–2.2	–2.0	–0.1	+0.5
Net wages and salaries	+2.7	+0.9	+0.2	+2.3	+2.8
Unit labor costs					
Total economy	+1.4	–0.5	–0.1	–0.1	+0.6
Manufacturing	–0.6	–1.0	–3.8	–2.6	–1.7
Relative unit labor costs[1]					
Vis-à-vis trading partners	+2.1	–3.0	–4.4	–1.8	–1.3
Vis-à-vis Germany	–0.2	–0.6	±0.0	–0.7	–0.3
Effective exchange rate – manufactures					
Nominal	+3.0	–1.2	–1.8	+0.4	+0.4
Real	+2.6	–1.5	–2.5	–0.4	–0.4

[1] Manufacturing, in a common currency; – . . . improvement of competitiveness.

PRIVATE CONSUMPTION EXPECTED TO EMERGE FROM STAGNATION

Weak wage increases and the restrictive fiscal stance depressed disposable income in 1997 and resulted in a stagnation of consumer expenditures, a hefty decline in the savings ratio notwithstanding. As both of these factors will lose in importance over the forecast period, higher income gains and a pick-up in domestic demand seem possible.

Nominal per-capita income rose by 1½ percent per year in 1996 and 1997. During the period of economic stagnation wage increases remained very restrained, the number of part-time jobs increased, and bonus payments and compensation in excess of rates as set in collective agreements were reduced. Thus, wages and salaries (adjusted for price increases) stagnated, but after-tax real income per employee declined by 2 percent in 1996 and 1997, as the result of comprehensive tax increases introduced by the austerity package.

Social transfer payments were also on the decline. Structural adjustments on the labor market and various measures to make working time more flexible will continue to limit income gains for wage and salary earners. Nonetheless, the upswing expected for 1998 and 1999 should significantly

Table 5: Private consumption

	1995	1996	1997	1998	1999
	Percentage changes from previous year, volumes				
Private consumption	+2.9	+2.4	+0.5	+1.5	+1.8
Durables	+0.9	+8.0	–4.0	+3.5	+2.8
Non-durables and services	+3.2	+1.6	+1.2	+1.2	+1.7
Net wages and salaries	+1.2	–1.6	–1.3	+0.6	+1.1
Household disposable income	+2.9	+0.7	–0.1	+2.0	+2.1
	As a percentage of disposable income				
Household saving ratio	10.2	8.6	8.0	8.5	8.8

raise incomes. Compensation per employee could rise by as much as 2 percent in 1998 and 2¾ percent in 1999. Fiscal policy could turn slightly less restrictive.

The rise in real disposable income (by 2 percent per year over the forecast period) will again boost private consumption, which in 1997 was supported only by a precipitous decline in the savings ratio from 10¼ percent in 1995 to the record low of 8 percent in 1997. In 1998 and 1999, private consumption is likely to grow by 1½ percent and 1¾ percent, with the savings ratio again gradually approaching the "normal" level. Turnover in retail trade posted a slight decline (–¾ percent in real terms) during the first three quarters of 1997, but wholesale trade profited from the upturn in foreign trade and manufacturing activity. The next two years should see a recovery in the trade sector (+2 percent each year in real terms).

PRICE STABILITY EXPECTED TO PERSIST

In the summer months the rate of inflation attained its lowest value since 1987. Consumer prices rose by only 1 percent on a year-on-year basis. Sluggish domestic demand and more intense competition in the area of manufactured goods and services eased inflationary pressures; so did the slowdown in the rise of rental prices. Over the next few months inflation is likely to pick up somewhat, the main factors being increases in public charges, the delayed effects of foreign-exchange induced import price hikes and the upswing in domestic demand. Moreover, there is the possibility that the increase in the value-added tax in Germany will spill over to Austria. On the other hand, the price-dampening effects of Austria's membership in the EU will persist, competitive pressures will remain strong and wage increases moderate. The high degree of price stability will be sustained; after 1.4 percent in 1997, inflation will rise only marginally to 1.5 percent in 1998 and in 1999.

PICK-UP IN DOMESTIC DEMAND SUPPORTS EMPLOYMENT GAINS

Employment (excluding persons in military service and on parental leave) rose by 13,000 on a year-on-year basis in the period from January to November 1997. Most of the employment gains were recorded in the area of producer-oriented services (including workers on loan to other firms) and in the public sector in the wide sense (including the education and health sectors), and concerned almost exclusively the female work force. The increase in the flexibility of working time and of shop opening hours strongly boosted the number of persons in precarious employment relations; in 1997, these persons were not covered by social security regulations and not recorded in the labor market statistics.

Table 6: Labor market

		1995	1996	1997	1998	1999
		Changes from previous year (in 1,000)				
Demand for labor						
Civilian employment		– 12.3	– 23.8	+ 8.7	+ 8.0	+ 27.0
Dependent employment[1]		– 2.5	– 20.9	+ 8.0	+ 7.5	+ 26.5
Excluding parental leave and military service		+ 0.6	– 16.5	+ 12.6	+ 18.0	+ 27.0
Percentage changes from previous year		+ 0.0	– 0.6	+ 0.4	+ 0.6	+ 0.9
Parental leave and military service[1]		– 3.2	– 4.4	– 4.5	– 10.5	– 0.5
Foreign workers[2]		+ 9.3	+ 0.0	– 2.0	+ 3.0	+ 3.0
Self-employed[3]		– 9.8	– 2.9	+ 0.7	+ 0.5	+ 0.5
Labor supply						
Total labor force		– 11.6	– 9.0	+ 10.7	+ 8.3	+ 23.0
Foreign		+ 8.7	+ 2.8	– 2.5	+ 2.0	+ 3.0
Migration of nationals		+ 5.6	+ 4.9	+ 5.0	+ 4.0	± 0.0
Indigenous		– 25.9	– 16.7	+ 8.2	+ 2.3	+ 20.0
Surplus of labor						
Registered unemployed[4]		+ 0.8	+ 14.8	+ 2.0	+ 0.3	– 4.0
In 1,000		215.7	230.5	232.5	232.8	228.8
Unemployment rate						
Percent of total labor force[5]	%	3.9	4.4	4.4	4.3	4.2
Percent of total labor force[4]	%	5.9	6.3	6.4	6.4	6.2
Percent of dependent labor force[4]	%	6.6	7.0	7.1	7.1	6.9
Participation rate[6]		67.5	67.2	67.2	67.2	67.3
Employment rate[7]		63.5	62.9	62.9	62.9	63.2

[1] According to Hauptverband der österreichischen Sozialversicherungsträger. – [2] Corrected for statistical breaks. – [3] According to WIFO. [4] According to labor exchange statistics. – [5] According to Eurostat. – [6] Total labor force as a percentage of active population (aged 15 to 64). – [7] Employment as a percentage of active population (aged 15 to 64).

The economic upturn is beginning to have an impact on the labor market. The demand for labor is expanding markedly, but is barely outpacing labor force growth. Thus, unemployment is receding just slightly. In 1999 the unemployment rate will decline to 6.9 percent and 4.2 percent, depending on the method of calculation.

So far, the pick-up in economic activity has not been mirrored in the labor market. The rising demand from abroad for manufactures has been mainly met by high productivity gains. The labor market is expected, however, to respond to the revival of domestic demand in the customary manner; dependent employment (excluding persons on parental leave and in military service) will expand by 18,000 in 1998 (+0.6 percent) and by 27,000 (+0.9 percent) in 1999.

Table 7: Key policy indicators

	1995	1996	1997	1998	1999
	Billion ATS				
Fiscal policy					
Central government net balance	–117.9	– 89.4	– 68.0	– 67.3	– 70.1
	As a percentage of GDP				
Central government net balance	– 5.1	– 3.7	– 2.7	– 2.6	– 2.6
General government financial balance	– 4.9	– 3.8	– 2.6	– 2.3	– 2.1
	In percent				
Monetary policy					
3-month interest rate (VIBOR)	4.6	3.4	3.5	4.0	4.4
Long-term interest rate[1]	7.1	6.3	5.7	5.7	5.9
Bond yield, average	6.5	5.3	4.9	5.1	5.5
	Percentage changes from previous year				
Effective exchange rate					
Nominal	+ 3.9	– 1.5	– 2.3	+ 0.5	+ 0.6
Real	+ 3.2	– 2.1	– 3.2	– 0.5	– 0.4

[1] 10-year central government bonds (benchmark).

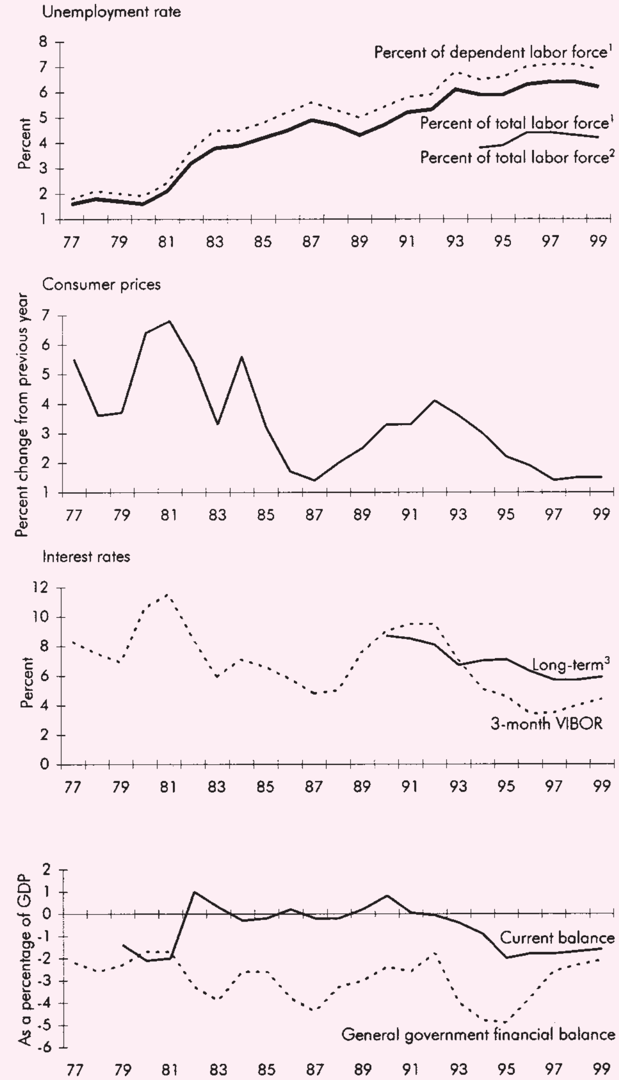
The rise in labor demand was almost matched by the increase in labor force supply. Much of the additional employment in the service sectors, benefiting mainly women, was drawn from the "hidden labor reserve". Unemployment, therefore, barely changed. In 1997, as a result of the elimination of the special pre-retirement benefit program, unemployment was even slightly higher than in 1996 and totaled 233,000. This level will be maintained in 1998, to be lowered only slightly in 1999 (–4,000). The unemployment rate will then drop to 6.9 percent of the dependent labor force according to the traditional Austrian method of calculation, to 4.2 percent of the total labor force according to the EU Labour Force Survey.

BUDGET CONSOLIDATION MAKES HEADWAY

Comprehensive measures to consolidate the budgets of the public sector have pushed net borrowing below the target level of 3 percent of GDP, but have also contributed to the weakness of domestic demand. The pick-up in economic activity, by way of the economic stabilizers, is gradually having a positive impact on the Federal budget.

In 1996 and 1997, the Federal government implemented a comprehensive austerity program: the financial deficit of the general government declined from 4.9 percent of GDP in 1995 to a likely 2.6 percent in 1997. In tandem with various measures to move items off-budget, this development guarantees that Austria will meet the convergence criteria for membership in the Monetary Union. The ratio of debt to GDP is also on the decline, attaining a level of 66 percent in 1997. At the same time, substantial tax increases and cuts in transfer payments have markedly curtailed the growth of disposable income and of private consumption.

Figure 2: Main economic indicators



[1] According to labor exchange statistics. – [2] According to Eurostat. – [3] Yield of 10-year central government bonds (benchmark).

Fiscal policy will be slightly restrictive over the forecast period. The acceleration of income growth and the strengthening of domestic demand will also help the fiscal performance of the public sector. The growth in revenues from direct taxes on private households and from social security contributions is picking up. Thus, the financial balance of the general government is expected to improve to a level slightly above the mark of –2 percent of GDP by 1999. This development is in accordance with the path agreed upon in the "EU Stability Pact", which mandates a further cut in the budget deficits, but leaves little maneuvering room for fiscal relief on the revenue and the expenditure side.

Cut-off date: December 17, 1997