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Economic Activity Moving Closer to its Potential in the Medium Term

Projections for the Austrian Economy until 2008

Until 2008 the Austrian economy is expected to grow by 2.3 percent per year, somewhat above the EU average. It will thereby move closer to its potential without facing serious capacity constraints. Prices should remain relatively stable. Growth will, however, not be strong enough to significantly reduce unemployment.

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In the course of 2004 cyclical impulses from the USA will induce an upturn of business activity in Europe, which should extend over the whole projection period. The biggest risk is currently the high euro exchange rate that may weaken the forward momentum of the European economy.

Gross Domestic Product in Austria is forecast to grow by 2.3 percent per year (at constant 1995 prices) between 2003 and 2008, and thus somewhat faster than in the 1997-2003 period (+2.1 percent p.a.).

In the years 2001 to 2003 Austria's economic performance was held back by a slowdown in international economic activity. In the following years economic growth should accelerate towards its potential owing to the expected improvement in global economic conditions. The rising labour supply will prove sufficient to accommodate this development.

A number of factors suggest that medium-term growth in Austria will be somewhat above the euro-area average:

- The tax reform will boost economic activity in 2005 by 0.3 percentage point and by a further 0.1 percentage point until 2007¹. The lower tax revenues will, however, widen the general government deficit to about 1½ percent of GDP in 2005; by 2008, the deficit should be reduced to ¼ to ½ percent of GDP under the impact of continued cyclical strength.
- The accession countries will benefit for the EU enlargement (Breuss, 2001). Austria as a major trading partner of these countries can expect considerable positive trade effects.
- Germany's sluggish economic performance has weighed on the Austrian economy over the last few years. If, as expected, Germany would catch up with the EU average, Austria should benefit as well.
- Residential construction, dragging down overall growth in recent years, is set to recover.
- Policy efforts to promote research and development in Austria should gradually yield its intended results.

¹ The impact of the first leg of the tax reform and its funding are not dealt with in the present context, as they have already been included in the baseline (i.e., the WIFO short-term projections of December 2003).

- Price competitiveness, as measured by unit labour costs, should continue to improve.
- Labour supply, notably of foreign workers, will keep rising strongly. This will stimulate growth and employment in traditional sectors but not necessarily in promising future areas such as information, communication or biotechnology. At the same time the prospects for lowering unemployment remain weak.

In the face of global competition, Austria will be able to maintain or raise its relatively high standard of living only if both private agents and public authorities are ready to invest more in education, research and development as well as in information and communication technology. If Austria were to succeed in narrowing the gap in this area vis-à-vis the USA and the leading European economies, prospects for an above-average growth are good. The present medium-term projections for real GDP growth are 2.1 percent p.a. between 2003 and 2008 for the euro area, 2.2 percent for EU 15, 2.3 percent for Austria and for EU 25.

Table 1: Main results

	Ø 1997- 2003	Ø 2003- 2008	2003	2004	2005	2006	2007	2008
Year-to-year percentage changes								
Gross domestic product								
Volume	+ 2.1	+ 2.3	+ 0.7	+ 1.7	+ 2.7	+ 2.5	+ 2.2	+ 2.4
Value	+ 3.5	+ 3.9	+ 2.5	+ 3.2	+ 4.2	+ 4.1	+ 3.8	+ 4.2
Consumer prices	+ 1.6	+ 1.2	+ 1.3	+ 1.2	+ 1.4	+ 1.1	+ 1.2	+ 1.3
Gross wages and salaries per employee ¹	+ 2.1	+ 2.3	+ 2.2	+ 2.2	+ 2.6	+ 2.3	+ 2.2	+ 2.2
Economically active employment ²	+ 0.6	+ 1.0	+ 0.2	+ 0.6	+ 1.1	+ 1.0	+ 1.0	+ 1.1
In percent								
Unemployment rate								
Eurostat definition ³	4.1	4.4	4.5	4.5	4.4	4.4	4.4	4.3
National definition ⁴	6.6	6.8	7.0	7.1	6.9	6.8	6.8	6.6
As a percentage of GDP								
Net exports	0.4	1.9	1.7	1.9	1.7	1.7	1.9	2.4
General government financial balance ⁵	- 1.1	- 0.9	- 0.9	- 0.9	- 1.5	- 1.1	- 0.7	- 0.3
As a percentage of disposable income								
Household saving ratio	8.0	8.5	7.9	8.3	9.1	8.9	8.4	7.9

Source: Statistics Austria, WIFO calculations. - ¹ Excluding employer contributions, employees according to National Accounts definition. - ² Excluding parental leave and military service. - ³ Excluding parental leave and military service. - ⁴ According to Labour Market Service, percent of total labour force excluding self-employed. - ⁵ According to Maastricht definition.

In view of Austria's accession to the EU and the opening of eastern Europe, the Austrian economy had been expected to grow at an above-average rate during the last decade; but GDP since 1995 has risen actually by no more than the EU average. In terms of GDP per capita at purchasing power parities, Austria lost some of its edge against the EU average due to immigration since 2000². These projections and ex-ante simulation exercises expect economic developments in Germany to be much more favourable than they actually turned out. Taking this effect into account, the effect of European integration on Austria is still positive (Breuss, 2003).

The expected growth in Austria will not allow the rate of unemployment to decline significantly during the next years, because at the same time the supply of labour (mainly from abroad) will rise strongly. By the year 2008, the unemployment rate will still amount to 4.3 percent (or 6.6 percent according to the national definition). Persistently high unemployment will put a lid on wage and price increases. In the early stages of an international business cycle upswing, major inflationary pressure is expected neither from raw materials nor energy prices. Price stability should be pre-

² According to preliminary EU calculations, Austrian GDP per capita at purchasing power parities was 14.7 percent above the EU average in 2000, and by 11 percent in 2003; for 2004 and 2005, the projections are for a positive gap of 10 percent.

served also from the demand side, as the output gap – defined as the deviation of actual from potential output – will turn slightly positive towards the end of the projection period. Thus, the rate of inflation should settle in between 1 percent and 1½ percent.

The present medium-term projection for the Austrian economy, developed with the WIFO macroeconomic model, extends the WIFO short-term forecast of December 2003. Unlike in the December forecast, the present projection incorporates the effects of the second leg of the tax reform scheduled for 2005. The assumptions concerning the international business cycle are elaborated elsewhere (see *Schulmeister, 2004*). Here only the elements crucial for the projection for Austria shall be briefly discussed.

The international framework

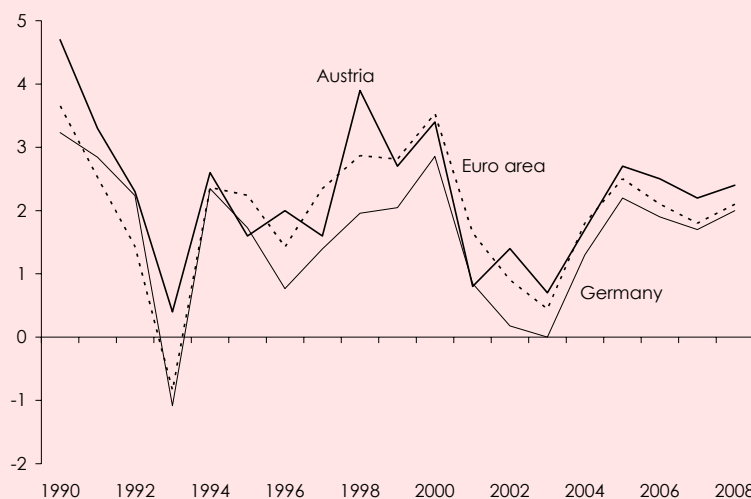
Table 2: International fundamentals

	Ø 1997-2003	Ø 2003-2008	2003	2004	2005	2006	2007	2008
Year-to-year percentage changes								
Real GDP								
USA	+ 3.0	+ 2.9	+ 2.8	+ 3.8	+ 2.5	+ 2.3	+ 2.8	+ 3.0
EU 15	+ 2.1	+ 2.2	+ 0.8	+ 2.0	+ 2.5	+ 2.3	+ 2.0	+ 2.3
Euro area	+ 2.0	+ 2.1	+ 0.4	+ 1.8	+ 2.5	+ 2.1	+ 1.8	+ 2.1
Germany	+ 1.3	+ 1.8	± 0.0	+ 1.3	+ 2.2	+ 1.9	+ 1.7	+ 2.0
Acceding countries	+ 3.1	+ 3.5	+ 2.8	+ 3.5	+ 4.0	+ 3.5	+ 3.0	+ 3.3
US\$ per ECU or Euro								
Exchange rate	1.01	1.12	1.13	1.16	1.14	1.12	1.10	1.08
In percent								
Euro area interest rates								
Long-term government bonds	4.8	4.3	4.1	4.0	4.5	4.3	4.3	4.5
3-month (EURIBOR)	3.5	2.6	2.3	2.0	3.0	2.5	2.5	3.0

Source: EU, OECD, WIFO calculations.

Figure 1: Growth of real GDP

Percentage changes from previous year



Source: EU, OECD, WIFO calculations.

Economic impulses from abroad are set to strengthen over the coming years. In the USA the cyclical upturn is gaining momentum. In Europe, although expectations have also clearly improved, economic growth will continue to lag behind the USA in

the next five years due slower growth in productivity and labour supply. A further retarding factor is the high euro-dollar exchange rate.

Table 3: Aggregate demand in Austria, the Euro area and Germany

In real terms, 1997-2003

	Austria	Euro area	Germany
	Average year-to-year percentage changes		
Consumption expenditure			
Private households ¹	+ 2.0	+ 2.2	+ 1.3
General government	+ 0.8	+ 2.1	+ 1.2
Gross fixed investment	+ 1.6	+ 2.1	- 0.8
Machinery and equipment ²	+ 3.0	+ 3.3	+ 1.9
Construction	+ 0.5	+ 1.0	- 2.7
Exports of goods and services	+ 7.0	+ 4.9	+ 6.0
Imports of goods and services	+ 5.9	+ 5.3	+ 4.8
GDP	+ 2.1	+ 2.0	+ 1.3

Source: EU, OECD, Statistics Austria, WIFO calculations. – ¹ Including private non-profit institutions serving households. – ² Including other products.

Germany, Austria's most important trading partner, grew significantly slower than the euro area in recent years. The main reasons were a slump in the construction sector, consumer and investor sentiments being undermined by the imminent reforms of the social welfare system, and the increasing attractiveness of other regions for business and investment (Table 3). However, Germany had performed better than the euro area in terms of exports, which can be regarded as an indicator of her international competitiveness. Without its foreign trade surplus, GDP would have stagnated over the last six years, whereas it grew on average by 1¼ percent per year. Investment and, to a greater extent, construction activity remained below the European average. A further aggravating factor was that given Germany's low inflation rate, its real interest rates were high, while southern European countries enjoyed low real interest rates. The common currency area seemed to favour exports of low-inflation countries, but weakened construction and investment activity in these countries. From 2003 to 2008 economic growth in Germany will only slightly trail that of the euro area.

EU enlargement scheduled for May 2004 will boost economic growth in the accession countries in the medium term. Foreign direct investment in these countries will become less risky, and subsidies from EU structural funds will be supportive to their economies. In addition, increasing competitive pressure across all economic sectors due to more foreign trade will boost productivity growth (Breuss, 2001). However, early participation of the acceding countries in EMU could inhibit the catching-up process, as they would still need to rely on exchange rate adjustments in order to maintain their competitiveness (Fidrmuc, 2003). A consistent fiscal and monetary policy should rein in speculative exchange rate movements.

Given the close economic ties with the accession countries, Austria will be influenced by the EU enlargement. Positive short-term effects should not be overestimated, as Austria will face the need for adjustments in border regions, the agricultural sector and the labour market. However, in the medium term Austria will benefit from the enlargement. The catching-up of the accession countries is a lasting process. The repercussions of EU enlargement on the domestic labour market will to a large extent show up only after the expiration of the regulatory transition period (Mayerhofer – Palme, 2002).

Economic developments in Eastern Europe are to a high degree determined by those in the European Union, as more than 70 percent of their exports go to the EU 15. The expected pick-up in economic growth in the EU should thus provide additional stimuli to the accession economies.

Impact of EU enlargement

The Austrian economy will benefit from the recovery in the key trading partner countries, as her exports are relatively price competitive due to only a moderate increase in unit labour costs. Exports at constant prices are expected to gain almost 6 per cent per year over the period from 2003 to 2008. Past experience shows that higher exports lead to a recovery of investment in machinery, vehicles and immaterial goods. This will initiate an increase in real disposable income that stimulates private consumption, which is expected to rise by 2½ percent p.a. over the projection period. At the same time the household saving ratio should pick up from a historical low. In the construction industry demand for housing should have levelled out by now, giving way to a gradual recovery over the next years.

Medium-term growth projection for Austria

Table 4: Aggregate demand

In real terms

	Ø 1997-2003	Ø 2003-2008	2003	2004	2005	2006	2007	2008
	Year-to-year percentage changes							
Consumption expenditure								
Private households ¹	+ 2.0	+ 2.5	+ 1.3	+ 1.8	+ 3.1	+ 2.9	+ 2.4	+ 2.3
General government	+ 0.8	+ 0.7	+ 0.5	± 0.0	+ 0.0	+ 1.0	+ 1.0	+ 1.2
Gross fixed investment	+ 1.6	+ 3.6	+ 2.5	+ 2.7	+ 4.5	+ 4.3	+ 3.3	+ 3.1
Machinery and equipment ²	+ 3.0	+ 5.3	+ 3.5	+ 4.0	+ 7.2	+ 6.6	+ 4.5	+ 4.1
Construction	+ 0.5	+ 2.1	+ 1.7	+ 1.7	+ 2.2	+ 2.3	+ 2.3	+ 2.2
Domestic demand	+ 1.6	+ 2.4	+ 1.5	+ 1.6	+ 2.9	+ 2.8	+ 2.4	+ 2.3
Exports of goods and services	+ 7.0	+ 5.8	+ 1.0	+ 4.8	+ 6.3	+ 6.0	+ 5.5	+ 6.5
Imports of goods and services	+ 5.9	+ 6.1	+ 2.4	+ 4.7	+ 6.9	+ 6.6	+ 5.9	+ 6.5
GDP	+ 2.1	+ 2.3	+ 0.7	+ 1.7	+ 2.7	+ 2.5	+ 2.2	+ 2.4

Source: Statistics Austria, WIFO calculations. – ¹ Including private non-profit institutions serving households. – ² Including other products.

The medium-term growth path in Austria will be largely determined by economic developments in the EU. Thus, the uncertainties surrounding the European business cycle play a key role.

Based on the experience of the last decade, among the OECD countries economic growth was above average in those countries in which

- investment in information and communication technology as well as in research, technology and education was high (USA, Finland, Sweden; see *Aiginger, 2003*);
- real estate prices experienced a boom, stimulating construction activity and private consumption while favouring a fall in the private household saving ratio (USA, UK, Scandinavia; see *Marterbauer – Walterskirchen, 2003*);
- economic policy followed an expansionary stance, e.g., through massive tax or interest rate cuts (USA);
- labour supply was abundant, be it induced by the natural demographic trend or immigration (USA).

As has been explained above, Austria may expect a rate of growth slightly above the average in the years to come owing to the tax reform, EU enlargement and investment in promising future areas such as research and development.

Although some details of the second leg of the tax reform are presently unknown, a tentative estimate of its likely macro-economic effects has been incorporated into this forecast. A more comprehensive analysis will have to wait until the final design of the reform is made public. Simulations with the WIFO macroeconomic model suggest that the second leg of the tax reform, which is scheduled for 2005³ will raise GDP by a cumulated 0.4 percent until 2007, with the bulk of the effect (0.3 percent) to be expected in the first year (*Aiginger – Kramer – Schratzenstaller, 2004*). Even if

Impact of the tax reform

³ The effects of the first leg of the tax reform and its financing are already incorporated in the baseline scenario.

Austria's tax reform would be followed by cuts in public expenditure, it should provide an economic stimulus in excess of the negative impact on Austria's exports due to dampened demand from countries in the process of budget consolidation (in particular Germany and France).

According to the present projections, which as far as public expenditure is concerned largely agree with those of Stability Programme by the Ministry of Finance (*Federal Ministry of Finance, 2003*), the general government deficit will rise to 1.5 percent of GDP due the tax reform and decrease thereafter to 0.3 percent of GDP by 2008⁴. The central government deficit will settle at above 2 percent of GDP in 2005, while the surplus by Länder (states) and Gemeinden (municipals) should reduce the general government deficit to around 1½ percent of GDP. Over the whole forecasting period, the deficit is expected to average at 1 percent of GDP, thereby significantly deviating from the target of a balanced budget over the business cycle.

Table 5: General government

	Ø 1997-2003	Ø 2003-2008	2003	2004	2005	2006	2007	2008
	Year-to-year percentage changes							
Revenues	+ 2.9	+ 2.5	+ 1.7	+ 2.2	+ 1.0	+ 3.2	+ 3.0	+ 3.1
Expenditures	+ 2.6	+ 2.3	+ 2.9	+ 2.2	+ 2.3	+ 2.5	+ 2.2	+ 2.2
GDP at current prices	+ 3.5	+ 3.9	+ 2.5	+ 3.2	+ 4.2	+ 4.1	+ 3.8	+ 4.2
	As a percentage of GDP							
General government financial balance ¹	- 1.1	- 0.9	- 0.9	- 0.9	- 1.5	- 1.1	- 0.7	- 0.3

Source: Statistics Austria, WIFO calculations. – ¹ According to Maastricht definition.

By moving deficit-ridden items off budget, financing of investment through leasing, changing housing subsidies from paid annuities towards loans, etc., the general government has been able to significantly reduce its deficit and public debt since the middle of the 1990s⁵. In the longer run, however, these transactions by regional authorities (in particular financing via leasing) will constitute a drag on the budget. Therefore, the sustainability of consolidation achieved so far needs to be better secured in the medium term. A number of structural problems can be identified both on the revenue and the expenditure side of the budget which, if untackled, may lead to a renewed deterioration of the budget balance or dampen the performance of the economy in the future.

In this respect the composition of government revenues characterized by a high share of social contributions and payroll taxes poses a major challenge given low labour force participation. Furthermore, fiscal policy should create room for counter-cyclical measures in the event of a new recession and meet the additional budgetary demands by pensions and health care in view of demographic developments between 2010 and 2030.

Employment is largely determined by the economic growth. At a projected average increase of GDP by 2.3 percent p.a., employment may rise by around 30,000 persons or 1 percent p.a. As in the past, a substantial portion thereof will enter part-time jobs. Labour markets will continue to become more flexible. In the years to come the bulk of additional jobs will be created in the tertiary sector, in particular, in commercial, health, nursing and other private services.

Particular consideration ought to be given to the medium-term trend of productivity. Over the next five years, real GDP per capita is expected to rise by 1.2 percent p.a.,

Unemployment barely falls

⁴ While the development of revenues at given tax rates is largely determined endogenously by the model, certain assumptions have been made for the expenditure side along the lines of the Stability Programme.

⁵ Mainly due to outsourcing of budget, the share of public investment has fallen from 3 percent of GDP in 1995 to 1.3 percent.

the same rate as in the period 1997-2003. The increasing number of part-time jobs will dampen productivity gains per capita, with a stronger rise in hourly productivity.

Table 6: Labour market and income

	Ø 1997-2003	Ø 2003-2008	2003	2004	2005	2006	2007	2008
	Year-to-year percentage changes							
Dependent employment	+ 0.7	+ 0.9	+ 0.9	+ 0.7	+ 1.1	+ 0.9	+ 0.9	+ 1.1
Economically active employment ¹	+ 0.6	+ 1.0	+ 0.2	+ 0.6	+ 1.1	+ 1.0	+ 1.0	+ 1.1
Registered unemployed	+ 0.5	- 0.3	+ 3.2	+ 1.5	- 1.6	+ 0.3	+ 0.4	- 1.9
Unemployment rate								
Eurostat definition ²	4.1	4.4	4.5	4.5	4.4	4.4	4.4	4.3
National definition ³	6.6	6.8	7.0	7.1	6.9	6.8	6.8	6.6
Labour productivity (GDP per employee ⁴)	+ 1.2	+ 1.2	+ 0.4	+ 1.1	+ 1.4	+ 1.3	+ 1.1	+ 1.1
Gross wages and salaries ⁵	+ 3.0	+ 3.4	+ 2.6	+ 2.9	+ 4.0	+ 3.5	+ 3.3	+ 3.5
Per employee ⁴	+ 2.1	+ 2.3	+ 2.2	+ 2.2	+ 2.6	+ 2.3	+ 2.2	+ 2.2
Unit labour costs, total economy	+ 0.5	+ 1.0	+ 1.8	+ 1.0	+ 1.1	+ 1.0	+ 0.9	+ 0.9

Source: Federation of Austrian Social Security Institutions, Statistics Austria, WIFO calculations. - ¹ Excluding parental leave and military service. - ² According to Eurostat Labour Force Survey. - ³ According to Labour Market Service, percent of total labour force excluding self-employed. - ⁴ According to National Accounts definition. - ⁵ Excluding employer contributions.

Figure 2: Labour market trends



Source: WIFO calculations. - ¹ As a percentage of total labour force (according to Eurostat). - ² Economically active as a percentage of working age population (15 to 64).

The increase in employment will, however, not be strong enough to have any substantial impact on unemployment. The number of jobless is projected to fall only marginally, from 240,000 in 2003 to 237,000 in 2008. According to the national definition, this will result in a rate of unemployment of 6.6 percent, or 4.3 percent according to Eurostat. The main reason for the persistence of unemployment is a strong rise in labour supply (foreign workers, the increase in the early retirement age, pro-cyclical variations of domestic labour supply) and the fact that the unemployed are generally looking for full-time jobs. The medium-term forecast for unemployment is, however, subject to particular uncertainty, as changes may cumulate over several years and the official unemployment figures are strongly influenced by institutional factors (training measures, etc.).

The high net immigration of labour recorded in the past will continue. It will postpone the demographic turning point brought about by low fertility rates and moderate its

impact to some extent. The predominantly young immigrants not only augment the population but also increase fertility rates, with a lasting impact on population and the labour force in the long run. These factors strongly influence projections for pension financing and the degree of shortage of skilled labour. Migration is strongly influenced by government policy such as the openness of the labour market to foreigners and the length of transition periods after the EU enlargement. As in recent years, a large share of the additional labour force will come from legal foreign residents, who so far did not have a work permit in Austria (Biffi – Bock-Schappelwein, 2003).

Since the qualification of foreign and elderly employees is on average lower than that of the young, training and life-long learning will become increasingly important if Austria is to keep its relative advantage in terms of per-capita income.

Inflationary pressure is set to remain low during the 2003-2008 projection period, as in the early phase of the cyclical upswing sufficient excess capacity exists. Even toward the end of the projection horizon, actual output is likely to exceed potential output by only a small margin, thereby mitigating concerns about major capacity bottle-necks. Furthermore, persistent high unemployment will have a moderating impact on wage settlements. Upward pressure on energy prices is likely to occur in the later stages of a global economic recovery.

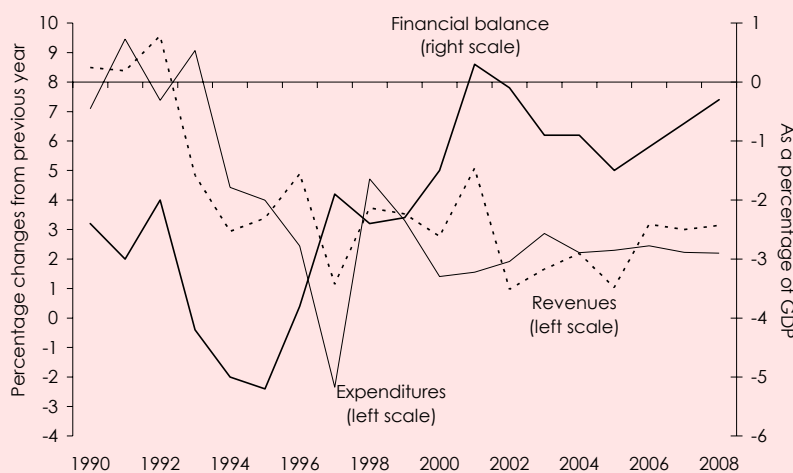
Continuing price stability

Table 7: Prices

	Ø 1997-2003	Ø 2003-2008	2003	2004	2005	2006	2007	2008
	Year-to-year percentage changes							
<i>Implicit price deflators</i>								
Private consumption	+ 1.2	+ 1.2	+ 1.3	+ 1.2	+ 1.4	+ 1.1	+ 1.2	+ 1.3
Exports of goods and services	+ 0.3	+ 1.2	- 0.0	+ 0.3	+ 0.7	+ 1.1	+ 1.6	+ 2.0
Imports of goods and services	+ 0.1	+ 0.7	- 0.6	+ 0.2	+ 0.6	+ 0.6	+ 1.0	+ 1.2
GDP	+ 1.3	+ 1.5	+ 1.8	+ 1.4	+ 1.4	+ 1.5	+ 1.6	+ 1.8

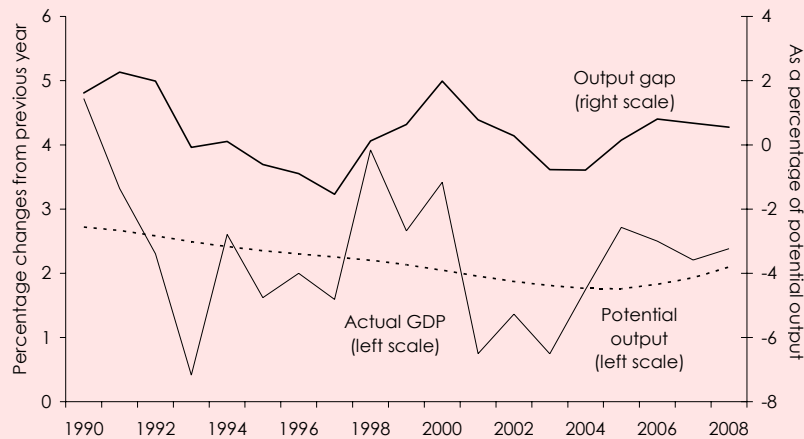
Q: Statistics Austria, WIFO- calculations.

Figure 3: Revenues, expenditure and financial balance (according to Maastricht) of general government



Source: Statistics Austria, WIFO calculations.

Figure 4: Output gap



Source: Statistics Austria, WIFO calculations.

Abstracting from unforeseeable events on international energy, commodity or financial markets, headline inflation should therefore remain below 1½ percent until 2008.

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Economic Activity Moving Closer to its Potential in the Medium Term

Projections for the Austrian Economy from 2003 to 2008 – Summary

In the course of 2004 cyclical impulses from the USA will set in motion an upturn of business activity in Europe, which should extend over the whole projection period. The biggest risk is currently the high euro exchange rate that may weaken the forward momentum of the European economy.

Under these circumstances Austria's GDP at constant 1995 prices is expected to expand by 2.3 percent p.a. from 2003 to 2008. Economic growth should thus exceed the 2.1 percent recorded over the period 1997-2003. From 2001 to 2003, economic activity in Austria was constrained by cyclical sluggishness abroad. In the following years, given the expected improvement in global economic conditions, Austria's economy should move towards its potential. Rising labour supply will provide sufficient scope to accommodate this development.

A number of factors suggest that medium-term economic growth in Austria will slightly exceed the euro area average:

- The tax reform will boost economic activity by 0.3 percentage point in 2005 and by a further 0.1 percentage point in the subsequent years. While the tax cuts will raise the general government deficit to around 1½ percent of GDP in 2005, the sustained cyclical revival should allow the deficit ratio to abate to between ¼ percent and ½ percent of GDP by 2008.
- EU enlargement will give sizeable benefits to the accession countries. As a major trading partner of these countries, Austria will take particular advantage from EU enlargement via its exports.
- Over the last years Germany's weak economic performance has weighed on Austria. If, as expected, Germany would catch up with the EU average, this should also have a positive effect on Austria's economy.
- Residential construction, dragging down overall growth in recent years, is set to recover.
- Policy efforts to promote research and development in Austria should gradually yield positive effects.
- Labour supply, notably of foreign workers, will keep rising strongly. This will stimulate growth and employment in traditional sectors but not in promising future areas such as information, communication or biotechnology.

In the face of global competition, Austria will be able to maintain or raise its relatively high standard of living only if both private agents and public authorities are ready to invest more in education, research and development as well as in information and communication technology. If Austria were to succeed in narrowing the gap in this area vis-à-vis the USA and the leading European economies, chances for an above-average pace of growth are good. The present medium-term projections for real GDP growth are 2.1 percent p.a. between 2003 and 2008 for the euro area, 2.2 percent for EU 15, and 2.3 percent for Austria as well as for EU 25.

In view of Austria's accession to the EU and the opening of eastern Europe, the Austrian economy had been expected to grow at an above-average rate during the last decade; but GDP since 1995 has risen actually by no more than the EU average. In terms of GDP per capita at purchasing power parities, Austria lost some of its edge against the EU average due to immigration since 2000. These projections and ex-ante simulation exercises had expected economic developments in Germany to be much more favourable than they actually turned out. Taking this effect into account, the effect of European integration on Austria is still positive.

The expected growth in Austria will not allow the rate of unemployment to decline significantly during the next years, because at the same time the supply of labour (mainly from abroad) will rise strongly. By the year 2008, the unemployment rate will still amount to 4.3 percent (or 6.6 percent on national definitions).

The persistently high unemployment will put a lid on wage and price increases. In the early stages of an international business cycle upswing, no major inflationary pressure is expected neither from raw materials nor energy prices. Price stability should be preserved also from the demand side, as the output gap – defined as the deviation of actual from potential output – will turn slightly positive towards the end of the projection period. Thus, the rate of inflation should settle in between 1 percent and 1½ percent.